Supreme Court, U.S.
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IN THE

Supreme Court of the United States

MAXIM PHARMACEUTICALS, INC.,
LARRY STAMBAUGH and KURT GEHLSEN,

Petitioners,

v.

CROSSPOINT VENTURE PARTNERS 1997, L.P., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEAL OF CALIFORNIA,
FOURTH APPELLATE DISTRICT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The United States Court of Appeals for the Ninth Circuit follows a largely discredited Second Circuit opinion and holds that tort claims are subject to only the broadest contractual arbitration provisions, even if the contract in question does not evidence a specific intent to exclude such claims. A majority of other Circuits have come to a contrary conclusion. However, California courts are bound to follow the Ninth Circuit's construction when interpreting the Federal Arbitration Act. Based on this minority view, courts in the Ninth Circuit have refused to compel arbitration of fraudulent inducement claims. Therefore, the questions presented are:

1. Whether a judicially crafted exception to the well-established federal policy in favor of arbitration should be allowed to flourish and grow.

2. Whether an appellate court should review arbitrability, *de novo*, when an arbitration agreement requires disputes to be settled in accordance with the Commercial Rules of the American Arbitration Association and parties voluntarily submit to arbitration.

3. Whether fraudulent inducement claims relate to the performance or interpretation of a contract if the alleged misrepresentations would constitute a breach of the agreement.

PARTIES TO THE PROCEEDINGS BELOW

The following persons and entities were plaintiffs-appellants to the proceedings below and are Respondents to this petition, but their names have been omitted from the caption hereto for administrative convenience:

3I BIOSCIENCE INVESTMENT TRUST PLC, CROSSPOINT VENTURE PARTNERS 1997, L.P., SBIC PARTNERS II, L.P., DOMAIN PARTNERS III, L.P., DP III ASSOCIATES, L.P., DOMAIN PARTNERS IV, L.P., DP iV ASSOCIATES, L.P., SANDERLING VENTURES PARTNERS IV, L.P., SANDERLING IV LIMITED, L.P., SANDERLING IV BIOMEDICAL, L.P., SANDERLING [FERI TRUST] VENTURE PARTNERS IV, G.P., SANDERLING VENTURE PARTNERS IV CO-INVESTMENT FUND, L.P., SANDERLING VENTURE BIOMEDICAL PARTNERS CO-INVESTMENT FUND, L.P. (AKA SANDERLING IV BIOMEDICAL CO-INVESTMENT FUND, L.P.), SANDERLING IV VENTURE MANAGEMENT G.P., ECKARD WEBER, M.D., FRED MIDDLETON, F. RICHARD NICHOL, PH.D., RICHARD CANOTE, JEFF VICK, MARVIN E. ROSENTHALE, PH.D., LOWELL SEARS, PRASAD SUNKARA, PH.D. and ROBERT G. MCNEIL.

STATEMENT PURSUANT TO RULE 29.6

Petitioner Maxim Pharmaceuticals, Inc. ("Maxim" or "Petitioner") has no parent corporation and no publicly held company owns 10% or more of its stock. Petitioner is a publicly-traded corporation listed on NASDAQ.

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Maxim respectfully Petitions for a Writ of Certiorari to review the judgment of the Court of Appeal of California, Fourth Appellate District in this case.

OPINIONS BELOW

The Opinion of the Court of Appeal of California, Fourth Appellate District, reversing the decision of the superior court, is reported at 2004 Cal. App. Unpub. LEXIS 11186 (2004). (App. A, *infra*, 1a.) The Order of the Court of Appeal of California denying the Petitioners' petition for rehearing and request for publication is reported at 2005 Cal. App. LEXIS 29 (2005). The Order of the Supreme Court of California denying the Petitioners' petition for review is reported at 2005 Cal. LEXIS 2103. (App. D, *infra*, 45a.)

STATEMENT OF JURISDICTION

The judgment of the Court of Appeal of California, Fourth Appellate District was entered on December 10, 2004. (App. A, *infra*, 1a.) The Court of Appeal denied a timely petition for rehearing and request for publication on January 4, 2005. On February 23, 2005, the Supreme Court of California denied a petition for review. (App. D, *infra*, 45a.) Petitioners invoke the jurisdiction of this Court under 28 U.S.C. § 1257(a).

STATUTORY PROVISIONS INVOLVED

Federal Arbitration Act, 9 U.S.C.S. § 1, *et seq.*

STATEMENT OF THE CASE

I. FACTUAL BACKGROUND

Maxim is a publicly-traded corporation whose shares trade on the NASDAQ. This case stems from Maxim's acquisition of a privately-held, start-up drug company, Cytovia, Inc. ("Cytovia"). Maxim acquired Cytovia through a complicated transaction by which (1) Cytovia merged with a Maxim subsidiary, (2) Cytovia's shareholders received shares of Maxim's publicly-traded stock in exchange for their Cytovia shares, and (3) Cytovia became a wholly-owned subsidiary of Maxim. The transaction was consummated through a series of agreements, integrated into an Agreement and Plan of Merger ("Merger Agreement"). Respondents are venture capitalists who were Cytovia's directors, officers and principal shareholders. (App. A, 4a.)

The gravamen of Respondents' complaint is that they were allegedly induced to believe that Maxim's flagship drug was going to be approved by the United States Food & Drug Administration for national marketing. Respondents contend that Petitioners provided false information and withheld facts, in contravention of duties under the Merger Agreement to provide full and complete information. Respondents claim that they were therefore fraudulently induced to approve of and consummate the merger, and accept Maxim stock in exchange for their Cytovia shares. As it turned out, Maxim's drug was not approved and its stock — and, consequently, the value of Respondents' shares — plummeted.

The Merger Agreement includes an arbitration clause which requires arbitration of all disputes that "relate to the interpretation or performance of" the Merger Agreement.

(*See* App. E at 46a.) The arbitration provision further requires such arbitration to be held in accordance with the Commercial Rules of the American Arbitration Association. (*See* App. E at 46a.)

II. PROCEEDINGS BELOW

1. On October 19, 2001, Respondents brought suit in San Diego Superior Court asserting claims of fraud and negligent misrepresentation, alleging that they were fraudulently induced to (1) approve of and agree to the merger, and (2) exchange their Cytovia shares for stock in Maxim. In their Complaint, Respondents requested their attorneys' fees as permitted "by law and/or contract."

2. On November 28, 2001, Petitioners petitioned the trial court to compel arbitration under the Federal Arbitration Act, arguing that the FAA applies because the underlying transaction and parties involve interstate commerce.

3. The trial court issued a tentative ruling granting the petition to compel arbitration. Pursuant to local rules, Respondents were directed to identify with specificity any issues they wished to address at oral argument. (*See* App. C at 44a.) Respondents identified as the sole issue whether they, as non-signatories, could be compelled to arbitration. Respondents did not seek further argument on the federal law question regarding the scope of the applicable arbitration provision. After oral arguments, the trial court confirmed its tentative ruling and ordered the parties to arbitration. (*See* App. C at 42a-44a.)

4. Respondents sought immediate review of the order compelling arbitration by a Writ of Mandate. In their writ

petition, Respondents again argued that they, as non-signatories should not be compelled to arbitrate their claims. Respondents did not mention the scope of the arbitration provision. The Court of Appeal of the State of California, Fourth Appellate District declined to issue a writ, allowing the arbitration to go forward.

5. Respondents commenced an arbitration with the American Arbitration Association by filing a Demand for Arbitration. (*See* App. B at 26a.) In their Arbitration Demand, Respondents asserted claims of fraud and negligent misrepresentation. Respondents also asserted a new claim for breach of contract, alleging the Petitioners breached the Merger Agreement. (*See* App. B at 27a-28a.) This breach of contract claim was not compelled to arbitration by the trial court, as Respondents did not assert a breach of contract claim in their superior court case. (*See* App. A at 14a.) In their Arbitration Demand, Respondents sought recovery of their attorneys' fees. They also stipulated that the prevailing parties were entitled to their fees, as provided by the Merger Agreement. (*See* App. E at 47a.)

6. One of the Respondents, Robert McNeil, was not a party to the original trial court proceedings, but sought to intervene in the arbitration proceedings. The arbitrators granted McNeil's motion to intervene. (*See* App. B at 27a.)

7. After a full evidentiary hearing, a panel of three neutral arbitrators issued an interim decision, ruling against Respondents on all claims. In their interim decision, the arbitrators determined that Petitioners were entitled to their attorneys' fees. (*See* App. B at 26a-27a.)

8. Respondents sought reconsideration of the interim decision, arguing that the arbitrators did not have power to award attorneys' fees. (*See* App. B at 40a-41a.) The arbitrators denied Respondents' motion, and issued a final award granting Petitioners' attorneys' fees. (*See* App. B at 23a-24a.)

9. Petitioners petitioned the trial court to confirm the arbitral award and enter judgment thereon. Respondents opposed this motion and filed their own motion to vacate the award. Respondents claimed that the matter should not have been submitted to arbitration and that the arbitrators did not have the power to award attorneys' fees. The trial court entered judgment in favor of Petitioners, confirming the arbitral award. (*See* App. B at 18a-21a.)

10. On January 30, 2004, Respondents filed a Notice of Appeal to the California Court of Appeal — the same court that had denied the pre-arbitration interlocutory writ. In their appeal brief, Respondents argued that the trial court had erred in ordering non-parties to arbitration. Alternatively (and briefly) Respondents argued that the scope of the arbitration agreement did not encompass their fraudulent inducement claims. In this alternative argument, Respondents cited to the Ninth Circuit rule that arbitration clauses regarding the interpretation and performance of a contract are "intended to cover a much narrower scope of disputes." (citing *Mediterranean Enters., Inc. v. Ssangyong Corp.*, 708 F.2d 1458 (9th Cir. 1983) and *Britton v. Co-op Banking Group,* 4 F.3d 742 (9th Cir. 1993)). In opposition, Petitioners argued that the Federal Arbitration Act compelled affirmance of the judgment.

11. The California Court of Appeal applied a *de novo* standard in reviewing the judgment. (*See* App. A at 11a.) In an unpublished decision, the Court of Appeal held that the applicable arbitration provision was too "narrow" to encompass the claims at issue. (*See* App. A at 8a.) Petitioners had cited, *inter alia*, *Hall v. Internet Capital Group, Inc.*, 271 F. Supp. 2d 332, 335 (D. Me. 2003) for the strong federal policy in favor of arbitration and the proposition that doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. (*See* App. A at 14a-15a.) Although the appellate court "assume[ed] without deciding that the FAA applies," it found reliance on *Hall* to be "misplaced": "*Hall* is distinguishable in that it involved an arbitration clause that was broad in scope." (*See* App. A at 15a.) The court explained that (1) the arbitration clause in question was limited to disputes "relating to the interpretation or performance" of the agreement, and (2) the representations and omissions at issue commenced before the Merger Agreement was fully executed. (*See* App. A at 13a.) Therefore, it held, Respondents' fraudulent inducement claims were "plainly outside the scope of the arbitration clause." (*See* App. A at 15a.)

12. The California Court of Appeal further explained that "but for the error in compelling arbitration" against the other Respondents, McNeil would not have intervened. (*See* App. A at 16a-17a.) Therefore it reversed the judgment as to all Respondents, including McNeil. (*See* App. A at 17a.)

13. Petitioners filed a petition for rehearing and request for publication, which was denied by the Court of Appeal on January 4, 2005. On February 23, 2005, the California Supreme Court denied a petition for review. (*See* App. D at 45a.)

REASONS FOR GRANTING THE PETITION

In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), when interpreting the scope of a "broad" arbitration provision, this Court expressly recognized that fraudulent inducement claims should be resolved by an arbitrator when "there is no evidence that the contracting parties intended to hold that issue from arbitration." *Id.* at 396. This decision enforces the Court's strong policy favoring arbitration.

Acting contrary to this policy and precedent, The Second and Ninth Circuits have established their own rules governing the interpretation of the scope of arbitration provisions. *See In re Kinoshita*, 287 F.2d 951 (2d Cir. 1961) (fraudulent inducement claim held to be outside the scope of "narrow" arbitration provisions) *and Mediterranean Enters.*, 708 F.2d 1458 (following the Second Circuit rule of interpretation). According to these Circuits, the *Prima Paint* presumption of arbitrability does not apply to "narrow" arbitration provisions, effectively creating a rule that a fraud in the inducement claim can only be arbitrated when such claim is expressly *included* in the arbitration provision, or there is a "broad" clause.

This new interpretation rule, as well as the Second and Ninth Circuits' rejection of a policy favoring arbitration, put the Second and Ninth Circuits in direct conflict with Supreme Court precedent, the majority of the federal Circuit courts, and state courts construing federal law, all of whom have repeatedly determined that fraud in the inducement claims should be arbitrated – even when a "narrow" arbitration provision exists.

Even the Second Circuit seems to recognize the Circuit conflict created by its *Kinoshita* decision, and has limited the holding to its precise facts. In so doing, it has moved towards the majority of Circuit Courts. However, district courts in the Second Circuit are bound by *Kinoshita's* holding if they cannot distinguish a "narrow" arbitration clause. The Ninth Circuit now stands alone in its presumption *against* arbitrability under less than "broad" arbitration provisions.

This Petition presents a "compelling" opportunity for the Supreme Court to resolve this circuit court conflict and reinforce its fundamental policy favoring arbitration.

I. BOTH FEDERAL AND STATE COURTS MUST APPLY FEDERAL LAW WHEN DETERMINING THE SCOPE OF AN ARBITRATION PROVISION WHERE THE UNDERLYING TRANSACTION INVOLVES INTERSTATE COMMERCE

The Federal Arbitration Act applies to arbitration agreements if the underlying transaction "involves" interstate commerce, even if the parties did not contemplate that interstate commerce would be affected. *See, e.g., Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265, 281 (1995). In determining whether the transaction involves interstate commerce, courts should look at the parties' business operations. *See Ideal Unlimited Services Corp. v. Swift-Eckrich, Inc.*, 727 F. Supp. 75 (D. Puerto Rico 1989). Here, there can be no doubt that the Merger Agreement, as well as Maxim's operations and those of Respondents involved interstate commerce. Both Maxim and Cytoria were involved in drug development. Respondents contend that

Petitioners misrepresented that Maxim's flagship drug would be approved by the FDA. Respondents further contend that as a result of these misrepresentations they were induced to accept shares of Maxim's publicly-traded stock. Thus, the FAA applied.

The crux of the opinion below was that the applicable clause was not broad enough to encompass Respondents' claims. This determination hinges on federal law. In its opinion, the California Court of Appeal stated that it was "assuming without deciding" that the FAA applies. (*See* App. A at 15a.) The appellate court cited to and relied exclusively on federal cases interpreting the FAA. (*See* App. A at 14a-15a.) Indeed, there should have been no question that federal law controlled.[1]

"Federal law in the terms of the Arbitration Act governs [arbitrability of a dispute] in either state or federal court." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983); *see also Tracer Research Corp. v. National Environmental Services Co.*, 42 F.3d 1292, 1294 (9th Cir. 1994) ("the scope of the arbitration clause is governed by federal law."). *Bismarck v. Toltz, King, Duvall, Anderson & Associates, Inc.*, 767 F.2d 429, 431 (8th Cir. 1985) ("Determining what claims fall within the class of disputes

[1] If it had applied California law, the appellate court would have come to a contrary conclusion. California law is in line with non-Ninth Circuit precedent establishing that, unless expressly excluded, fraudulent inducement claims are subject to more-narrow arbitration provisions. *See Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street*, 35 Cal.3d 312, 323 (1983) (clause requiring arbitration of disputes "with respect to the provisions of" the contract, while not the broadest, nonetheless encompasses a fraud in the inducement claim).

governed by an arbitration agreement is a question of federal law."); *Hart v. Orion Ins. Co.*, 453 F.2d 1358, 1361 (10th Cir. 1971) ("The validity and interpretation of arbitration clauses affecting interstate commerce are governed by federal law.").

Not only does federal law apply in this case, there are no adequate and independent state law grounds for the Court of Appeal's decision. While Respondents had argued that they, as non-signators to the Merger Agreement, could not be bound to arbitrate their claims, that argument did not provide a basis for the Court of Appeal's decision. Nor could it. Although this question is arguably a matter of state law, the Court of Appeal assumed that Respondents could be bound. (*See* App. A at 10a-11a.) This was the correct conclusion under California law.[2] *See, e.g.*, *NORCAL Mutual Ins. Co. v. Newton*, 84 Cal. App. 4th 64 (2000) (nonsignator bound under estoppel theory); *Mormile v. Sinclair*, 21 Cal. App. 4th 1508, 1511 (1994) (nonsignator bound by arbitration agreement); *Harris v. Superior Court*, 188 Cal. App. 3d 475, 479 (1986) (same).

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[2] In an entirely different context, this Court recently stated, in *dicta*, that "a contract cannot bind a nonparty." *Equal Employment Opportunity Commission v. Waffle House*, 534 U.S. 279, 294 (2002). The Court found that the EEOC's remedies were not limited simply because an employee on whose behalf it was litigating had signed an arbitration agreement. Nothing in *Waffle House* affects the analysis here. Indeed, since *Waffle House*, courts have continued to recognize that nonsignatories may be bound to arbitrate. *E.g.*, *Restoration Pres. Masonry, Inc. v. Grove Europe Ltd.*, 325 F.3d 54, 63 n.2 (1st Cir. 2003) (explaining that *Waffle House* stated only a general principle; non-signatories "may be bound by or acquire rights under an arbitration agreement under ordinary state-law principles of agency or contract"); *Metalclad Corp. v. Ventana Environmental Org. Partnership*, 109 Cal. App. 4th 1705, 1717 (2003) (nonsignatory plaintiff estopped from avoiding arbitration provision).

II. THE NINTH CIRCUIT HAS ESTABLISHED AN EXCEPTION TO THE PRESUMPTION IN FAVOR OF ARBITRATION, REFUSING TO COMPEL ARBITRATION IN THE ABSENCE OF A CLEAR INTENT TO EXCLUDE CLAIMS

It has been almost forty years since this Court answered the question whether arbitrators or courts should resolve a claim that a contract (as opposed to an arbitration provision) was fraudulently induced. *See Prima Paint*, 388 U.S. 395. "[W]here there is no evidence that the contracting parties intended to withhold that issue from arbitration," the issue is within an arbitrator's purview. *Id.* at 396. The Court explained that in so holding, "we not only honor the plain meaning of the statute but also the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Id.* at 404.

In reaching its holding in *Prima Paint*, the Court noted that the arbitration provision before it was "broad," as it required arbitration of any claim or controversy "arising out of or relating to" the agreement or the breach thereof. *Id.* at 398.

The Second Circuit and then the Ninth Circuit latched onto the word "broad," finding the holding of *Prima Paint* inapplicable to more "narrow" arbitration agreements. As stated by the Second Circuit, a provision that requires arbitration of disputes "arising under" a contract is limited to controversies related to interpretation and performance of the contract. *In re Kinoshita*, 287 F.2d 951. Such a provision does not require arbitration of a fraudulent inducement claim. *Id.*

The Second Circuit rule has been adopted by the Ninth Circuit. *See Mediterranean Enters.*, 708 F.2d at 1463. The Ninth Circuit stated that "arising hereunder" is synonymous with "arising under" (the phrase in *Kinoshita*) and is restricted to matters relating to the interpretation and performance of the agreement. *Id.* at 1464. Several years later, the Ninth Circuit reiterated this rule, finding the phrase "arising out of" to have the same limited scope as the phrase in *Mediterranean. Tracer*, 42 F.3d at 1295. As a result, the Ninth Circuit explained, even if a tort claim would have not arisen "but for" the contract does not mean such claim is arbitrable. *Id.* at 1295. Under the "narrow" phrase, if a tort claim does not depend on an interpretation of the contact, it is not arbitrable. *Id.*

Under the Second Circuit rule, courts must follow a two-step procedure to determine whether a specific dispute is arbitrable. Courts must (1) examine the arbitration clause's language and classify the clause as either broad or narrow; and (2) determine whether the issue or dispute in question is collateral or non-collateral to the underlying agreement. *Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001), *citing Mehler v. Terminix Int'l Co.*, 205 F.3d 44, 49 (2d Cir. 2000) If the arbitration clause is narrow, the court will not order arbitration for "collateral" matters. *Id.*

Although the procedural steps are not as clearly enunciated, the Ninth Circuit has adopted the Second Circuit rule. *See Mediterranean Enters.*, 708 F.2d at 1463. In another context, the California Court of Appeal, Fourth Appellate District explained (a month after authoring the underlying opinion here) that the Ninth Circuit's rule means a more narrow provision "encompasses only those actions directly

involving the application of [the subject contract] in specific factual contexts addressed by the [subject contract]." *MHC Financing Ltd. Partnership Two v. City of Santee*, 125 Cal. App. 4th 1372, 1398 (2005).

Here, the California Court of Appeal cited to *Mediterranean* and explained that the policies and presumptions in favor of arbitration were inapplicable because the arbitration clause was "narrow." (*See* App. A at 10a.) The appellate court therefore held that a fraudulent inducement of contract claim — the same type of claim at issue in *Prima Paint* — should not have been arbitrated.

In contrast to the Second and Ninth Circuits (and the California Court of Appeal), federal courts in the Fourth, Fifth, Sixth, Seventh, and Eleventh Circuits (as well as state courts construing federal law) have compelled arbitration of fraudulent inducement claims under similar, narrowly-worded arbitration provisions.[3] These courts have held that

[3] Fraudulent inducement-type claims have been compelled under provisions with the following "narrow" language: "arising out of," *Highlands Wellmont Health Network, Inc. v. John Deere Health Plan, Inc.*, 350 F.3d 568, 578 (6th Cir. 2003); "with respect to any amount," *Wellborn Clinic v. Medquist, Inc.*, 301 F.3d 634, 640 (7th Cir. 2002); "which may arise hereunder," *Gregory v. Electro-Mech. Corp.*, 83 F.3d 382, 383-85 (11th Cir. 1996); "relating to a breach of this agreement," *Matthews v. Rollins Hudig Hall Co.*, 72 F.3d 50, 54 (7th Cir. 1995); "arising out of," *Sweet Dreams Unlimited, Inc. v. Dial-A-Mattress Int'l, Ltd.*, 1 F.3d 639, 643 (7th Cir. 1993); "believed to constitute a breach or violation," *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.*, 867 F.2d 809, 813-14 (4th Cir. 1989); "with respect to the interpretation or performance," *Mar-Len of Louisiana, Inc. v. Parsons-Gilbane*, 773 F.2d 633, 636 (5th Cir. 1985); "with respect to the interpretation of this Agreement or the performance of

(Cont'd)

because there is a federal policy in favor of arbitration, claims of fraudulent inducement should be excluded from arbitration only where the parties expressed an intent to exclude them.

For example, the Seventh Circuit has held that fraudulent inducement claims are arbitrable under a provision that

(Cont'd)
the respective obligations of the parties," *Schacht v. Beacon Ins. Co.*, 742 F.2d 386, 391 (7th Cir. 1984); "under," *PNI, Inc. v. Leyton*, No. 03-1344-MO, 2004 U.S. Dist. LEXIS 13335, *16 (D. Or. 2004); "that may arise between" the parties, *Coffer v. Service Asset Mgmt. Co.*, No. 02 Civ. 9934 (DC), 2003 U.S. Dist. LEXIS 19676, *10 (S.D.N.Y. 2003); "arising under or in connection with," *Thies v. Lifeminders, Inc.*, No. 02-2119 KHV, 2002 U.S. Dist. LEXIS 22284, *29-30 (D. Kan. 2002); "under," *Prescott-Follett & Assoc., Inc. v. Delasa*, No. 01-3178, Section I/2, 2002 U.S. Dist. LEXIS 21988, *11 (E.D. La. 2002); "arising out of," *Weiss v. Travex Corp.*, No. 02 Civ. 2380 (SAS), 2002 U.S. Dist. LEXIS 12782, *9 (S.D.N.Y. 2002); "arising out of this transaction," *Automated Tech. Mach., Inc. v. Diebold, Inc.*, No. 01-2777, Section "C" (2), 2002 U.S. Dist. LEXIS 9146, *15 (E.D. La. 2002); "as to interpretation of," *RCM Tech., Inc. v. Brignik Tech. Inc.*, 137 F. Supp. 2d 550, 555 (N.J. 2001); "under the terms of," *Goldberg v. Focus Affiliates, Inc.*, 152 F. Supp. 2d 978, 982 (N.D. Ill. 2001); "concerning the interpretation or performance of any provision," *Integrated Health Serv., Inc. v. Kirschenbaum*, No. 95 C 7233, 1996 U.S. Dist. LEXIS 3165, *17-18 (N.D. Ill. 1996); "involving questions of interpretation of," *Hannah Furniture Co. v. Workbench, Inc.*, 561 F. Supp. 1243, 1244-45 (W.D. Pa. 1983); "arising out of" the agreement or "arising out of the interpretation or application," *Information Sciences, Inc. v. Mohawk Data Science Corp.*, 403 N.Y.S.2d 730, 732 (1978); "arising out of," *Griffin v. Semperit of America, Inc.*, 414 F. Supp. 1384, 1391 (S.D. Tex. 1976); "the effect or interpretation of any terms or provisions," *J.P. Stevens & Co., Inc. v. Harrell Int'l, Inc.*, 299 So. 2d 69, 70 (Fla. 1st DCA 1974) "arising out of," *Birmingham News Co. v. Lynch*, 797 So. 2d 440, 444 (Ala. 2001); "arising hereunder," *Aerojet-Gen. Corp. v. Non-Ferrous Metal Refining, Ltd.*, 322 N.Y.S.2d 33, 532 (N.Y. 1971).

requires arbitration of disputes "with respect to the interpretation of this Agreement or the performance of the respective obligations of the parties under this Agreement." *Schacht v. Beacon Ins. Co.*, 742 F.2d 386, 390-391 (7th Cir. 1984). The Seventh Circuit reiterated the "strong federal policy in favor of arbitration" and said an order to arbitrate a particular grievance "should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage." *Id.* (quoting *United Steelworkers v. Gulf Navigation Co.*, 363 U.S. 574, 582-83 (1960)); *see also Thies v. Lifeminders, Inc.*, No. 02-2119–KHV, 2002 U.S. Dist. LEXIS 22284, *31 (D. Kan. 2002) (fraudulent inducement claims arose "under or in connection with" a merger agreement and were therefore arbitrable).

In fact, the Second Circuit itself, which originated the rule followed by the Ninth Circuit, has seemed to back away from it. Since *Kinoshita* was decided in 1961, the Second Circuit has consistently distinguished cases in which variants of the "arising under" language were at issue and that court has permitted arbitration of fraudulent inducement claims. *See Ace Capital Re Overseas Ltd. v. Cent. United Life Ins. Co.*, 307 F.3d 24, 26 (2d Cir. 2002) ("any dispute **shall arise between** the parties hereto **with reference to the interpretation**" of the agreement) (emphasis added); *Genesco, Inc. v. T. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 854-55 (2d Cir. 1987) ("all claims and disputes **of whatever nature arising under** this contract") (emphasis added); *S.A. Mineracao Da Trindade-Samitri v. Utah Int'l, Inc.*, 745 F.2d 190, 192-94 (2d Cir. 1984) (any dispute that "**shall arise or occur under**" the contract) (emphasis added).

The Second Circuit has repeatedly limited *Kinoshita*'s holding to its *precise* facts, although it has declined to overturn it. *See Genesco, Inc.*, 815 F.2d at 854 n.6; *S.A. Mineracao Da Trindade-Samitri*, 745 F.2d at 194; *see also Battaglia v. McKendry*, 233 F.3d 720, 725-27 (3d Cir. 2000) (although decided under Pennsylvania law, the court thoroughly analyzed *Kinoshita* and its progeny and found the rule stated by the Second and Ninth Circuits to be out of step with federal policy favoring arbitration). Indeed, since *Kinoshita* was published, the Second Circuit has never applied its holding and excluded a fraudulent inducement claim from a more narrow arbitration clause. However, because the Second Circuit has not overturned *Kinoshita,* district courts in the Second Circuit remain constrained to follow it. *See Bristol-Myers Squibb Co. v. SR Int'l Business Ins. Co.*, 354 F. Supp. 2d 499 (S.D.N.Y. 2005) (refusing to compel arbitration, stating that although *Kinoshita* is "out of step with the overwhelming body of law favoring arbitration," *Kinoshita* remains binding because the Second Circuit has refused to overrule it).

Similarly, *Mediterranean* and *Tracer* remain the law in the Ninth Circuit, leaving courts to distinguish what facially appear to be very similar arbitration provisions. *See Simula, Inc. v. Autoliv, Inc.*, 175 F.3d 716 (9th Cir. 1999) (distinguishing provision which required arbitration of disputes "arising in connection with this agreement" and compelling tort claim); *Metalmark N.W., L.L.C. v. Stewart*, No. 04-682-K1, 2004 U.S. Dist. LEXIS 18258 (D. Or. 2004) (finding "concerning" to be broader than "arising under"); *Chloe Z Fishing Co., Inc. v. Odyssey Re Ltd.*, 109 F. Supp. 2d 1236 (S.D. Cal. 2000) ("concerning any claim under," or "arising out of or in connection with" is broader than in

Mediterranean); *McMillin Dev., Inc. v. Builders Structural Services, Inc.*, No. 96-3458J (LSP), 1997 U.S. Dist. LEXIS 6809 (S.D. Cal. 1997) (factually distinguishing *Mediterranean* where provision required arbitration of disputes "that arise between" the parties "as to satisfactory compliance with [the contract] or construction standards"); *Prograph Int'l Inc. v. Barhydt*, 928 F. Supp. 983 (N.D. Cal. 1996) (fraudulent inducement claim compelled under provision which required arbitration of any dispute "in connection with" the agreement).

As with the Second Circuit, the Ninth Circuit has not seen fit to overturn *Mediterranean* and *Tracer*. A court in the Ninth Circuit is therefore constrained to make a seemingly conclusory distinction between "narrow" clauses (such as those at issue in *Mediterranean* and *Tracer*) and "broad" clauses. If the court is unable to distinguish a clause from a "narrow" one, the Ninth Circuit's holdings apply and arbitration will be refused except as to contract claims.

This Court has previously stated that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration and "any doubt concerning the scope if arbitrable issues should be resolved in favor of arbitration. . . ." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 650 (1986) (finding the presumption in favor of arbitration "particularly applicable" where the clause is broad);[4] *Mitsubishi Motors Corp.*

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[4] The clause at issue in *AT&T Technologies* required arbitration of differences "arising with respect to the interpretation of this contract or the performance of any obligation hereunder. . . ." 475 U.S. at 650. The Court stated, in *dicta*, that this clause was broad. It is, however, indistinguishable from the Ninth Circuit's definition of a "narrow" provision.

v. Soler Chrysler-Plymouth, 473 U.S. 614, 628 (1985) ("it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act.") The Ninth Circuit and Second Circuit add a threshold requirement before applying this policy. Under this minority view, courts have to determine a gateway issue: is the policy at issue broad or narrow? Only when a court determines it is construing a broad provision is it required to resolve all doubts in favor of arbitration.

Prior dictates of this Court have made clear the presumption in favor of arbitration means that arbitration should be compelled unless claims are clearly outside the scope of an applicable provision. Said another way, unless parties have expressed an intent to exclude claims, arbitration should be compelled. The Ninth Circuit and Second Circuit have reversed this presumption, based on the use of the word "broad" in prior Supreme Court cases. While the majority of Circuits disagree, there is certainly some doubt; doubt that has powerful impact on arbitration.[5] This Court should resolve this split and explicitly state that unless expressly excluded fraudulent inducement must be compelled under contractual arbitration provisions.

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[5] In this case, Petitioners incurred over a million dollars in attorneys fees in the arbitration. (*See* App. B at 18a-21a). Respondents likely invested a similar amount. Both sides — and three neutral arbitrators — invested substantial time in arbitrating these claims. The arbitrators then spent additional time adjudicating the claims.

III. WHETHER A MATTER IS ARBITRABLE IS NOT FOR THE COURTS TO DECIDE IF THE APPLICABLE ARBITRATION AGREEMENT INCORPORATES RULES WHICH ALLOW THE ARBITRATORS TO MAKE THIS DETERMINATION AND PARTIES VOLUNTARILY SUBMIT TO ARBITRATION

Under the Federal Arbitration Act, there is a general presumption that the issue of arbitrability — whether a particular matter is encompassed by an arbitration provision — should be resolved by the courts. *See, e.g., First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944-45 (1995). Indeed, whether an arbitration provision applies to a particular controversy is a "gateway" or threshold issue for the court to decide. *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 452 (2003) (contrasting the gateway issue to a question of what kind of arbitration the parties had agreed to, which is not a gateway issue for the courts); *Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 84 (2002) (while a disagreement about whether an arbitration clause applies to a particular type of controversy is for the court, determining how the applicable arbitration rules should be applied is the abitrators' domain); *AT&T Technologies*, 475 U.S. at 656 (the question of arbitrability is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise). However, where the parties have "clearly and unmistakably" provided that the question of arbitrability should be decided by the arbitrator, then the matter should be sent to arbitration. *See Howsam*, 537 U.S. at 83 (quoting *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. at 649).

Here, there was clear and unmistakable evidence that the question of arbitrability was to be decided by the arbitrators. The Commercial Arbitration Rules of the American Arbitration Association provide that the arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement. *See Contec Corp. v. Remote Solution Co., Ltd.*, 398 F.3d 205, 208 (2d Cir. 2005). The applicable arbitration provision incorporated Commercial Arbitration Rules of the American Arbitration Association. (*See* App. E at 46a.) "[W]hen, as here, parties explicitly incorporate rules that empower an arbitrator to decide issues of arbitrability, the incorporation serves as clear and unmistakable evidence of the parties' intent to delegate such issues to an arbitrator." *Contec Corp.*, 398 F.3d at 208 (holding that arbitration was the proper forum for determining whether a valid arbitration agreement exists).[6]

Moreover, one of the Respondents, McNeil, voluntarily submitted to the arbitration. (*See* App. B at 27a.) McNeil then argued, along with the other Respondents, that he could not be compelled to pay Respondents' attorneys' fees because he was not a party to the Merger Agreement. (*See* App. B at 40a-41a.) In other words, McNeil voluntarily came to the arbitration and asked the arbitrators to determine arbitrability.[7] The arbitrators

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[6] There is a Circuit spilt on this issue. *See Contec Corp.*, 398 F.3d at 210-211 (comparing *Shaw Group Inc. v. Triplefine Int'l Corp.*, 322 F. 3d 115, 120 (2d Cir. 2003) and *Apollo Computer v. Berg*, 886 F.2d 469 (1st Cir. 1989) with *Microchip Tech. Inc. v. U.S. Philips Corp.*, 367 F.3d 1350 (Fed Cir. 2004)).

[7] The other Respondents also asked the arbitrators to determine arbitrability by challenging the arbitrators' authority to award attorneys' fees. However, only McNeil's intervention was addressed on appeal.

determined that McNeil was a proper party to the arbitration who could be compelled to pay attorneys' fees. (*See* App. B at 27a, 40a-41a.) This finding is not reviewable on appeal. *See PowerAgent, Inc. v. Elec. Data Sys. Corp.*, 358 F.3d 1187, 1191 (9th Cir. 2004) (after requesting an arbitral decision on arbitrability, plaintiff "is now bound by the arbitration panel's findings on arbitrability and the merits unless it can overcome the *highly deferential* standard of review employed by the federal courts regarding arbitrator's holdings"); *see also Baer v. Terminix*, 975 F. Supp. 1272, 1279 (D. Kan. 1997) ("a party that agrees to submit the question of arbitrability to the arbitrator waives any right to later object to the arbitrator's authority" to rule on the question); *see also Colon v. Federal Reserve Bank*, 538 F. Supp. 498, 501 (N.D. Cal. 1982) ("A claimant may not voluntarily submit the issue to arbitration, await the outcome, and, if the decision is unfavorable, then challenge the authority of the arbitrators to act."); *see also Delaney v. Continental Airlines*, No. SACV 92-762-GLT, 1993 U.S. Dist. LEXIS 9868, *12 (C.D. Cal. 1993) (rejecting plaintiff's claim that he was not bound to arbitrate his dispute because he appeared and presented his case in arbitration).

The California Court of Appeal did not apply a deferential standard to the arbitrators' decision concerning McNeil. Instead, the appellate court applied its independent judgment. (*See* App. A at 11a.) The court mentioned that McNeil voluntarily intervened (over Petitioners' objections). It ignored, however the federal cases holding that by voluntarily entering the arbitration, McNeil was bound by the arbitrators' findings. Instead, the Court of Appeal simply distinguished a state case, explaining that because "there was no 'mandatory' arbitration procedure," McNeil's intervention had no impact. (*See* App. A at 16a-17a.)

Where, as here, parties voluntarily submit to arbitration under the Commercial Arbitration Rules of the American Arbitration Agreement, they should not be allowed to challenge the arbitrators' findings by appeal to the courts.

IV. FRAUDULENT INDUCEMENT CLAIMS RELATE TO INTERPRETATION OR PERFORMANCE OF AN AGREEMENT IF THE ALLEGED MISREPRESENTATIONS WOULD CONSTITUTE A BREACH OF THE AGREEMENT

Even if the Court were to find that the type of arbitration provision at issue here was more narrow than the provision in *Prima Paint*, Respondents' claims that they had been fraudulently induced to enter into and approve of the Merger Agreement were properly arbitrable.

The arbitration provision at issue here requires arbitration of all disputes that "relate to the interpretation or performance of" the Merger Agreement. (*See* App. E at 46a.) The Court of Appeal concluded that because some of the defendants' misrepresentations commenced prior to the execution of the agreement containing the arbitration provision, plaintiffs' fraud claims did not relate to performance of the contract and were not arbitrable. (*See* App. A at 13a-14a.) The Court of Appeal focused entirely on the word "performance," totally ignoring the phrase "relate to." The Court of Appeal also overlooked the fact that "performance" is not complete at the moment it commences.

Under the appellate court's reasoning, only breach of contract claims would have been arbitrable. This eviscerates the arbitration clause because after the merger was completed Cytovia ceased to exist except as a wholly-owned subsidiary

of Maxim. Therefore, the only disputes for which Cytovia could have sought arbitration would have been pre-merger representations or omissions — exactly those claims which the appellate court found to be outside the scope of the arbitration provision.

Moreover, while some of the alleged wrongful acts took place before execution of the Merger Agreement, others clearly did not. Under the Merger Agreement, Maxim had a continuing obligation to ensure that its representations were accurate and did not contain any material omissions. Indeed, Cytovia could have terminated the merger if any of Maxim's representations became inaccurate after execution of the Merger Agreement. Finally, these representations and warranty obligations survived for a year after the merger.

If Respondents' allegations were true, Petitioners would have breached contractual duties. In other words, Respondents claim they were injured by Petitioners' performance under the Merger Agreement.

Further, the record shows that Respondents' counsel conceded before the trial court that "had there been a breach of a representation and warranty prior to the closing [of the merger transaction] and there was a dispute about it, that issue would go to arbitration." This admission exposes the illogic of the Court of Appeal's conclusion that Respondents' claims are "plainly" outside the scope of the arbitration clause. At the very least, this raised a doubt whether Respondents' claims were arbitrable. This doubt should have been resolved in favor of arbitration.

V. THIS ISSUE IS ONE OF GREAT IMPORTANCE, TRANSCENDING THE DISPUTE BETWEEN THE PARTIES

In enacting the Federal Arbitration Act, surely Congress intended uniform application of the law. However, in interpreting *Prima Paint* and its progeny, Circuit courts have created a non-uniform body of law that provides no guidance to future courts and litigants. The Ninth Circuit and Second Circuit have extracted one word out of this Court's numerous decisions reiterating the policy in favor of arbitration. These courts have used this word, "broad," to create an exception to this policy.

Under the Ninth Circuit and Second Circuit rule, as adopted by the California Court of Appeal, "narrow" arbitration clauses are read restrictively, reversing the presumption in favor of arbitration. As demonstrated by the numerous cases in which courts go to great length to distinguish near identical language, even this rule is applied in a haphazard and unpredictable manner.

The ever-expanding loophole created by the Second Circuit and embraced by the Ninth Circuit should be closed. Otherwise parties will continue to contract for arbitration, expecting that their disputes will be arbitrated; courts will continue to compel arbitration; fees will be incurred and time invested, only to have the whole process erased because an appellate court decides, *de novo* and after the fact, that an arbitration provision was "narrow." It is hard to imagine a scenario that more clearly flies in the face of the federal policy in favor of arbitration.

CONCLUSION

This Court has frequently stated the strong federal policy in favor of arbitration and a presumption of arbitrability. However, the Second and Ninth Circuits reversed this presumption for "narrow" arbitration provisions. The uneven application of this exception flies in the face of the policies stated by this Court. It is time to stop this rule from spreading even further, and provide uniform guidance to courts and unsuspecting litigants.

Petitioners respectfully request that the members of this Court grant their Petition for a Writ of Certiorari.

Respectfully submitted,

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APPENDIX A — OPINION OF THE COURT OF APPEAL, FOURTH APPELLATE DISTRICT, DIVISION ONE, STATE OF CALIFORNIA FILED DECEMBER 10, 2004

COURT OF APPEAL, FOURTH APPELLATE DISTRICT
DIVISION ONE
STATE OF CALIFORNIA

D043787

(Super. Ct. No. GIC776631)
(Super. Ct. No. GIC785032)

CROSSPOINT VENTURE PARTNERS 1997 et al.,

Plaintiffs and Appellants,

v.

MAXIM PHARMACEUTICALS, INC., et al.,

Defendants and Respondents;

ROBERT G. McNEIL,

Intervener and Appellant.

APPEAL from a judgment of the Superior Court of San Diego County, S. Charles Wickersham, Judge. Reversed and remanded for further proceedings.

Appendix A

Plaintiffs Crosspoint Venture Partners 1997 et al.,[1] who are former stockholders of Cytovia, Inc. (Cytovia), and Robert G. McNeil (McNeil), who is not one of the plaintiffs in this case but who intervened in the arbitration proceeding at issue here,[2] appeal a judgment entered in favor of defendants Maxim Pharmaceuticals, Inc. (Maxim Pharmaceuticals), and Maxim's principals, Kurt Gehlsen, Ph.D., and Larry Stambaugh (collectively Maxim). Cytovia, a San Diego-based biotechnology company, merged with Maxim Pharmaceuticals after the latter completed a clinical trial of a new anti-cancer drug it had developed, Maximine, for which it was seeking approval by the Food and Drug Administration (FDA). As part of the merger transaction, which was completed pursuant to the

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1. The plaintiffs in this matter are Crosspoint Venture Partners 1997; SBIC Partners II, LP; Domain Partners III, LP; DP III Associates, LP; Domain Partners IV, LP; DP IV Associates, LP; Sanderling Ventures Partners IV, LP; Sanderling IV Limited, LP; Sanderling IV Biomedical, LP; Sanderling [Feri Trust] Venture Partners IV; Sanderling Venture Partners IV Co-Investment Fund; Sanderling Venture Biomedical Partners Co-Investment Fund, LP; Sanderling IV Venture Management; Eckard Weber, M.D.; Fred Middleton; F. Richard Nichol, Ph.D.; Richard Canote; Jeff Vick; Marvin E. Rosenthale, Ph.D.; Lowell Sears; and Prasad Sunkara, Ph.D.

2. In their appellants' reply brief, the Cytovia shareholders and McNeil assert that "McNeil is a member of Sanderling Ventures and a trustee of the Sanderling Management Co. LLC Retirement Trust FBO Robert McNeil, both of which were parties compelled to arbitration. McNeil only intervened when Maxim challenged those plaintiffs' standing after they were ordered to arbitration. As a partner of the entities ordered to arbitration, McNeil also was forced to arbitrate his claims, as the partnership through which he received shares of Maxim stock had been compelled to arbitrate."

provisions of a written merger agreement (the agreement), the plaintiffs (hereafter referred to as the Cytovia shareholders) exchanged their Cytovia stock for Maxim Pharmaceuticals stock. The Cytovia shareholders had approved the merger, but did not sign the agreement, which contained an arbitration clause that required "the parties" to arbitrate disputes "relating to the *interpretation or performance* of [the agreement]." (Italics added.)

After the merger was completed, the FDA denied Maxim Pharmaceuticals' new drug application. The Cytovia shareholders brought suit against Maxim for fraud and negligent misrepresentation, alleging they had agreed to the merger and the exchange of stock based on material misrepresentations and omissions by Maxim regarding the clinical testing and negative communications from the FDA.

The court granted Maxim's petition to compel arbitration of the Cytovia shareholders' tort claims, finding they were third party beneficiaries of the agreement. A panel of arbitrators thereafter ruled in favor of Maxim. The court confirmed the arbitration award and entered judgment in Maxim's favor, awarding attorney fees and costs to Maxim in the amount of almost $923,000.

On appeal, the Cytovia shareholders and McNeil (collectively appellants where appropriate) contend the court erred by compelling them to arbitrate their claims under an agreement to which they were not parties. Specifically, they contend (1) it is undisputed that they were not parties to the agreement, and Maxim never asserted they were; (2) the court erred by ruling they were third party beneficiaries, (3) agency

principles did not bind them to the arbitration clause; and (4) their tort claims were outside the narrow scope of the arbitration clause. We conclude that because the Cytovia shareholders' claims against Maxim did not relate to the "interpretation or performance" of the agreement within the meaning of the arbitration clause, the claims fell outside the scope of that clause, the court erred by compelling arbitration of the claims, and thus the judgment must be reversed as to both the Cytovia shareholders and McNeil.

FACTUAL BACKGROUND

Cytovia was a San Diego-based, privately held biotechnology company. It was funded by biotechnology-focused venture capital firms and individual investors.

In June 2000, Maxim, a publicly traded company, acquired Cytovia through a merger in which the Cytovia shareholders received Maxim stock in exchange for their Cytovia stock. Central to the merger, according to the Cytovia shareholders, were Maxim's representations that the Phase III clinical trial of Maxim Pharmaceuticals' new drug, Maximine, had been completed in March 2000, and the results demonstrated a statistically significant increase in survival for patients suffering from metastatic melanoma, an extremely serious form of skin cancer, who were treated with a combination of Maximine and interleukin-2 (IL-2).

The merger was based on a written merger agreement (the agreement) executed in June 2000, which expressly recited that the three parties to that agreement were Maxim Pharmaceuticals, Maxim Pharmaceuticals' acquisition

company M-80 Acquisition Corporation (M-80), and Cytovia. Regarding the rights of third parties, section 10.14 of the agreement provided that, "[e]xcept for the provisions of Sections 1.5 and 1.6, none of the provisions of [the agreement] is intended to provide any rights or remedies to any Person other than the parties hereto." The agreement also contained an arbitration clause that required "the parties" to arbitrate disputes "relating to the *interpretation or performance* of [the agreement]." (Italics added.)

In December 2000, about six months after completion of the merger, the FDA denied Maxim Pharmaceuticals' new drug application for Maximine.

PROCEDURAL BACKGROUND

A. *The Cytovia Shareholders' Complaint*

The Cytovia shareholders[3] brought suit against Maxim for fraud and negligent misrepresentation. In their complaint, they alleged they had agreed to the merger and the exchange of stock based on material misrepresentations and omissions by Maxim about the purported success of the clinical testing of Maximine and about negative communications Maxim had allegedly received from the FDA regarding that testing.

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3. As already noted, McNeil was not named as a plaintiff in the Cytovia shareholders' complaint.

Appendix A

B. *Maxim's Petition To Compel Arbitration and the Court's Order*

Maxim petitioned the court for an order compelling arbitration of the Cytovia shareholders' claims. Maxim claimed that the Cytovia shareholders were bound by the arbitration clause in the agreement even though they did not sign the agreement, and that their claims were subject to arbitration. In their written opposition, the Cytovia shareholders argued that they were not parties to, or intended third party beneficiaries of, the agreement; thus they had not agreed to be bound by the arbitration clause; and their tort claims against Maxim were outside the scope of the arbitration clause because the claims did not relate to the interpretation or performance of the agreement.

The court issued a telephonic ruling granting Maxim's petition to compel arbitration of the Cytovia shareholders' tort claims.[4] Following oral argument, the court confirmed the telephonic ruling, finding that the Cytovia shareholders were obligated to arbitrate their claims because they were third party beneficiaries of the agreement. The court did not address the Cytovia shareholders' argument that their claims were outside the scope of the arbitration clause.

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4. The telephonic ruling stated in part: "[Maxim's] motion to compel arbitration is granted and the action is stayed pending arbitration. [The Cytovia shareholders] are third party beneficiaries of the Merger Agreement (see Section 1.5). Therefore, [the Cytovia shareholders] are bound by the arbitration clause even though most of them did not sign it."

Appendix A

C. *Arbitration, Award and Judgment*

McNeil intervened in the court-ordered arbitration proceedings, at the conclusion of which a panel of arbitrators issued an interim decision in favor of Maxim and found that Maxim, as the prevailing party, was entitled to recover its reasonable attorney fees and costs. The court thereafter confirmed the arbitration award and entered judgment in Maxim's favor, awarding it attorney fees and costs in the amount of almost $923,000. This timely appeal by the Cytovia shareholders and McNeil followed.[5]

STANDARD OF REVIEW

"'Whether an arbitration agreement applies to a controversy is a question of law to which the appellate court applies its independent judgment where no conflicting extrinsic evidence in aid of interpretation was introduced in the trial court.' [Citation.]" (*NORCAL Mutual Ins. Co. v. Newton* (2000) 84 Cal.App.4th 64, 71.)

DISCUSSION

In their written opposition to Maxim's petition to compel arbitration, the Cytovia shareholders argued that they were not parties to, or intended third party beneficiaries of, the agreement, and thus they had not agreed to be bound by the arbitration clause. They also argued that their fraud and negligent misrepresentation claims against Maxim were outside the scope of the arbitration clause because the claims

5. The notice of appeal was filed on behalf of the Cytovia shareholders and McNeil.

did not relate to the interpretation or performance of the agreement. The court found that the Cytovia shareholders were obligated under the arbitration clause to arbitrate their claims because they were third party beneficiaries of the agreement. The court, however, did not rule on the Cytovia shareholders' argument that their claims were outside the scope of the arbitration clause.

Appellants argue that the court erred by compelling arbitration of the Cytovia shareholders' claims because the tort claims alleged in the complaint were outside the narrow scope of the arbitration clause set forth in the agreement. We conclude that those claims were outside the scope of the arbitration clause, and thus the court erred by compelling arbitration.

A. *Applicable Legal Principles*

Under Code of Civil Procedure section 1281.2,[6] it is the province of the trial court to determine whether there is a duty to arbitrate a particular controversy that has arisen between contracting parties. (*United Transportation Union v. Southern Cal. Rapid Transit Dist.* (1992) 7 Cal.App.4th 804, 808.) "In performing its duty to determine if the parties have agreed to arbitrate that type of controversy, the court is necessarily required 'to examine and, to a limited extent, construe the underlying agreement.' [Citation.] [¶] Doubts as to whether an arbitration

6. With exceptions not applicable here, section 1281.2 of the Code of Civil Procedure provides: "On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists."

clause applies to a particular dispute are to be resolved in favor of sending the parties to arbitration. The court should order them to arbitrate unless it is clear that the arbitration clause cannot be interpreted to cover the dispute. [Citation.]" (*Ibid.*; *Engineers & Architects Assn. v. Community Development Dept.* (1994) 30 Cal.App.4th 644, 652.)

However, the right to arbitration rests upon contract, as "[t]here is no public policy favoring arbitration of disputes which the parties have not agreed to arbitrate." (*Engineers & Architects Assn. v. Community Development Dept.*, *supra*, 30 Cal.App.4th at p. 653.) Indeed, despite California's strong policy favoring arbitration, the substantial right of a litigant to pursue claims in a judicial forum is not lightly to be deemed waived, as " 'the general policy favoring arbitration cannot replace an agreement to arbitrate.' [Citations.]" (*Mayhew v. Benninghoff* (1997) 53 Cal.App.4th 1365, 1371.) Simply stated, a party cannot be compelled to arbitrate a dispute that that party has not elected to submit to arbitration.

B. *Analysis*

Here, it is undisputed that the arbitration clause set forth in sections 10.18 and 10.19 of the agreement required "the parties" to arbitrate disputes "relating to the *interpretation or performance* of [the agreement]."[7] (Italics added.) As a

7. Section 10.18 of the agreement provides in part: "*If a dispute arises between the parties relating to the interpretation or performance of* [*the agreement*], including any right of setoff, and the parties cannot resolve the dispute within 30 days of a written request by either party to the other, such dispute shall be referred to the Chief Executive Officer, Chief Financial Officer or General Counsel of [Maxim Pharmaceuticals] and Chief Executive Officer, Chief Financial Officer or General Counsel (Cont'd)

preliminary matter, we note the narrow scope of the arbitration clause. In *Mediterranean Enterprises, Inc. v. Ssangyong Corp.* (9th Cir. 1983) 708 F.2d 1458, 1464, the Ninth Circuit Court of Appeals recognized both the narrow scope of an arbitration clause that restricts arbitration to " 'disputes . . . relating to the *interpretation* of the contract and matters of *performance* ' " (italics added) and the broader scope of a clause that contains the phrase "'arising out of or relating to,' the standard language recommended by the American Arbitration Association." (See also *American Recovery Corp. v. Computerized Thermal Imaging, Inc.* (4th Cir. 1996) 96 F.3d 88, 93 [acknowledging that the phrase "arising out of or relating to" in an arbitration clause is broader in scope and "capable of an expansive reach"].)

We assume without deciding that the Cytovia shareholders were either parties[8] to, or intended third party

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(Cont'd)

of [Cytovia] for resolution." (Italics added.) With exceptions not relevant here, section 10.19 of the agreement provides in part: "*Disputes that have not been successfully resolved pursuant to Section 10.18 . . . shall be settled by* a panel of three arbitrators with such *arbitration* to be held in San Diego, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof." (Italics added.)

8. Maxim concedes that the Cytovia shareholders (with the exception of Weber) were not signatories to the agreement. Maxim asserts, however, that the Cytovia shareholders "entered into Shareholder Agreements that *had* to be executed along with the [agreement] in order to effectuate the transaction," and "[w]hen the Merger transaction is viewed in its totality it is obvious that [the Cytovia shareholders] were parties." (Boldface & fn. omitted.)

beneficiaries, of the agreement such that they were contractually bound to arbitrate any disputes covered by the provisions of the arbitration clause. Because there is no showing that conflicting extrinsic evidence in aid of interpretation of the arbitration clause was introduced in the trial court, the question of law we must determine de novo (*NORCAL Mutual Ins. Co. v. Newton*, *supra*, 84 Cal.App.4th at p. 71) is whether the Cytovia shareholders' claims relate to the "interpretation or performance" of the agreement such that the claims are within the scope of the arbitration clause.

The record shows that the Cytovia shareholders' complaint asserted causes of action against Maxim for fraud and negligent misrepresentation. Specifically, they alleged that because the Phase III clinical trial of Maximine was critical to the merger discussions, Cytovia retained Dr. Randolph Steer, a consultant, in April 2000 to review the information provided by Maxim regarding the clinical trial. They also alleged that in early May 2000, after Maxim Pharmaceuticals issued a press release announcing positive results from the clinical trial,[9] Steer, Eckard Weber, M.D.,[10]

9. The complaint alleged that "[o]n May 2, 2000, Maxim [Pharmaceuticals] issued a press release announcing the 'first results' from the Phase III clinical trials. The press release read: 'Treatment with Maximine plus IL-2 improved survival duration over treatment with IL-2 alone in all six patient populations analyzed in the study. In addition, consistent with the results of earlier Phase II studies, the improvement in survival provided by treatment with Maximine was most significant in patients having metastases of their melanoma to the liver, a patient population that historically has a very poor prognosis for survival.'"

10. Weber was Cytovia's founder, president, chief executive officer, and chairman of the board of directors.

and others from Cytovia met with Stambaugh, Gehlsen and others from Maxim Pharmaceuticals, who gave a presentation about Maxim Pharmaceuticals, Maximine, and the Phase III clinical trial. At that meeting, Steer allegedly asked Maxim for the entire file concerning the Phase III clinical trial, specifically including the correspondence file with the FDA, and Maxim provided him with a file containing 15 to 20 pages of documents, which included correspondence between Maxim Pharmaceuticals and the FDA, as well as minutes of meetings between Maxim Pharmaceuticals and the FDA. The complaint alleged that Gehlsen, when questioned, represented to Steer that the file, which was allegedly filled with glowing reports about the communications with the FDA, was complete, there were no other communications between Maxim Pharmaceuticals and the FDA, and the file showed no negative communications from the FDA.

The Cytovia shareholders further alleged in their complaint that in early June 2000 Maxim Pharmaceuticals issued another press release to induce them to support the proposed merger, which stated: "The [Phase III clinical trial] results show that the immunomodulating agent Maximine used in combination with a lower dose regimen of [IL-2], improved survival for stage-IV malignant melanoma patients compared with those treated with the same doses of IL-2 alone." A week later, Maxim Pharmaceuticals allegedly distributed to the Cytovia shareholders an information statement representing that Maxim completed its Phase III clinical trial of Maximine in March 2000, and "the results demonstrated a statistically significant increase in survival for patients with the combination of Maximine plus [IL-2]."

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The complaint further alleged that the Cytovia shareholders, in reliance on Maxim's representations, voted to approve the merger and accept shares of Maxim Pharmaceuticals in exchange for their Cytovia stock; that in December 2000, the FDA's Oncologic Drug Advisory Committee unanimously denied Maxim's new drug application for Maximine; that the FDA's medical officer preliminary review of Maxim's new drug application found several flaws with Maxim's Phase III clinical trial and described in detail a history of written and oral communications between the FDA and Maxim dating back to April 1997, which Maxim had withheld from Cytovia and its shareholders, in which the FDA was extremely critical of the clinical trial; and that as a result of their reliance on the foregoing misrepresentations and omissions, the Cytovia shareholders, who would not have approved the merger had Maxim disclosed the true facts, suffered damages.

As the foregoing factual allegations demonstrate, the Cytovia shareholders' tort claims against Maxim involve a dispute relating to a series of allegedly fraudulent representations and omissions made by Maxim that commenced *prior* to the Cytovia shareholders' approval of the merger and the execution of the agreement in June 2000. The allegations show that the claims in question do not involve a dispute relating to the interpretation of the agreement, nor do they involve a dispute relating to the performance of the executed agreement. We conclude that the claims arose from allegedly tortious conduct that commenced before the expressly identified parties—Maxim Pharmaceuticals, M-80 and Cytovia—executed the agreement, and thus do not relate to the performance of the executed agreement.

Because the claims do not involve a dispute "relating to the *interpretation or performance* of [the agreement]" within the plain meaning of the arbitration clause at issue here, we also conclude the claims are outside the scope of the arbitration clause. Thus, even if we were to assume for purposes of this appeal that the Cytovia shareholders were either parties to, or third party beneficiaries of, the agreement, the record shows they did not agree to arbitrate the claims alleged in their complaint, and the court erred by compelling the Cytovia shareholders to arbitrate the claims.

Maxim complains that appellants "willingly" added a new claim for breach of the agreement in their demand for arbitration dated August 21, 2002. The record shows, however, that the addition of this claim in August 2002 occurred only *after* the court compelled arbitration in this matter in January 2002 following the Cytovia shareholders' vigorous efforts to oppose arbitration and defend their right to a jury trial. We view the addition of the new claim as a legal advocate's effort to exhaust every reasonable means to obtain a recovery on behalf of the clients.

We reject Maxim's contention that the Federal Arbitration Act (the FAA), title 9 United States Code section 1 et seq., compels affirmance of the judgment in this matter. The FAA "requires arbitration of a claim where a contract contains a written arbitration provision and where the contract evidences a transaction involving interstate commerce." (*Hall v. Internet Capital Group, Inc.* (D.Me. 2003) 271 F.Supp.2d 332, 334 (*Hall*).) The district court explained in *Hall* that "[t]he Supreme Court has recently reiterated that the FAA expresses a strong federal policy favoring arbitration

agreements. [Citations.]" (*Ibid.*) However, the *Hall* court also explained that the FAA establishes, as a matter of federal law, that "any *doubts* concerning the scope of arbitrable issues should be resolved in favor of arbitration." (*Ibid.*, italics added.) Here, Maxim's reliance on *Hall*, which also involved a question about the scope of an arbitration clause in a merger agreement, is misplaced. *Hall* is distinguishable in that it involved an arbitration clause that was broad in its scope. The *Hall* court stated: "Keeping in mind that any ambiguity in the language must be construed in favor of arbitration, here the parties agreed that the subject arbitration provision would *broadly cover any dispute 'arising out of' or 'relating to' the Merger Agreement.*" (*Id.* at p. 335, italics added.) Here, in contrast, as already discussed, the arbitration clause in question was narrowly limited in scope to disputes "relating to the interpretation or performance of [the agreement]." Assuming without deciding that the FAA applies, it does not compel affirmance of the judgment because, for reasons already discussed, the claims are plainly outside the scope of the arbitration clause. Because the court erred in compelling arbitration, we conclude it also erred in awarding fees and costs in favor of Maxim.

Last, we reject Maxim's contention that the judgment, including the order confirming the arbitrators' decision and the award of attorney fees and costs in favor of Maxim, should be affirmed as to McNeil on the ground he waived his right to appeal the arbitrability of his claims by voluntarily intervening in the arbitration proceeding. Maxim's reliance on *Valley Casework, Inc. v. Comfort Construction, Inc.* (1999) 76 Cal.App.4th 1013 is misplaced. As Maxim points out, this court explained in *Valley Casework* that "[a] person who

voluntarily joins an arbitration proceeding becomes a party to it and may be estopped from claiming to be exempt from the mandatory arbitration procedure. [Citation.]" (*Id.* at p. 1021.) However, we also explained in that case that "[a] proceeding to compel arbitration is equivalent to an *equitable action for specific performance of a contract.* [Citation.]" (*Ibid.*, italics added.) We further explained that "'"judicial enthusiasm for alternative methods of dispute resolution 'must not in all contexts override the rules governing the interpretation of contracts[,]' as *the policy favoring arbitration cannot displace the necessity for a voluntary agreement to arbitrate.* [Citations.]'" [Citation.]" (*Id.* at p. 1022, italics added.)

Here, we have concluded (for reasons discussed, *ante*) that the court erred in compelling arbitration in this matter because the claims asserted in the Cytovia shareholders' complaint were outside the scope of the arbitration clause. In other words, contrary to Maxim's contention, the Cytovia shareholders had not voluntarily agreed to arbitrate their claims. In addition, the arbitrators' decision shows that McNeil sought to intervene—over Maxim's objection—only *after* the court erroneously compelled arbitration and *after* the witnesses completed their testimony.[11] From this record we may reasonably infer that but

11. The arbitrators's written decision stated that "[*a*]*fter* the conclusion of testimony" (italics added), Maxim made oral motions to dismiss the claims of certain claimants or, alternatively, to abate the proceedings as to certain claimants. The decision also stated: "Claimants submitted briefs in opposition thereto . . . ; [Maxim] submitted a reply [.] Claimants also submitted a motion for leave for [McNeil] to intervene and to be joined as a Claimant; [Maxim] opposed that motion. Upon reviewing the arguments, and considering the oral and written submissions, [Maxim's] motions ... are DENIED, and Claimants' motion for intervention and joinder as a Claimant of [McNeil] is GRANTED. . . ."

for the error in compelling arbitration, McNeil would not have intervened in the arbitration proceeding. Because there was no voluntary agreement to arbitrate the Cytovia shareholders' claims, there was no "mandatory" arbitration procedure within the meaning of *Valley Casework, Inc. v. Comfort Construction, Inc., supra*, 76 Cal.App.4th at page 1021. For the foregoing reasons, we conclude the judgment must be reversed as to all of the appellants, including McNeil, notwithstanding his intervention in the arbitration proceeding.[12]

DISPOSITION

The judgment is reversed in its entirety, and the matter is remanded for further proceedings. Appellants shall recover their costs on appeal.

s/ Nares
NARES, Acting P.J.

WE CONCUR:

s/ McIntyre
McINTYRE, J.

s/ Aaron
AARON, J.

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12. In light of our conclusions, we need not reach the merits of the appellants' remaining contentions that (1) it is undisputed that the Cytovia shareholders were not parties to the agreement, and Maxim never asserted they were; (2) the court erred by ruling that the Cytovia shareholders were third party beneficiaries, and (3) agency principles did not bind the Cytovia shareholders to the arbitration clause.

APPENDIX B — JUDGMENT OF THE SUPERIOR COURT OF CALIFORNIA, COUNTY OF SAN DIEGO, CENTRAL DIVISION FILED DECEMBER 23, 2003

**SUPERIOR COURT OF CALIFORNIA,
COUNTY OF SAN DIEGO
CENTRAL DIVISION**

CASE NOs. GIC776631 and GIC785032
[consolidated]

[Code of Civil Procedure § 1287.4]

DEPT: 73
JUDGE: S. Charles Wickersham

COMPLAINT FILED: October 19, 2001

CROSSPOINT VENTURE PARTNERS 1997, et al.,

Plaintiffs,

v.

MAXIM PHARMACEUTICALS, INC., et al.,

Defendants.

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MAXIM PHARMACEUTICALS, INC.,
KURT GEHLSEN; and LARRY STAMBAUGH,

Petitioners,

3i Bioscience Investment Trust PLC, Crosspoint Venture Partners 1997, L.P., SBIC Partners II, L.P., Domain Partners III, L.P., DP III Associates, L.P., Domain Partners IV, L.P., DP IV Associates, L.P., Sanderling Ventures Partners IV, L.P., Sanderling IV Limited, L.P., Sanderling IV Biomedical, L.P, Sanderling [Feri Trust] Venture Partners IV, G.P., Sauderling Venture Partners IV Co-Investment Fund, L.P., Sanderling Venture Biomedical Partners Co-Investment Fund, L.P. (aka Sanderling IV Biomedical Co-Investment Fund, L.P.), Sanderling IV Venture Management, G.P., Eckard Weber, M.D., Fred Middleton, F. Richard Nichol, Ph.D., Richard Canote, Jeff Vick, Marvin E. Rosenthale, Ph.D., Lowell Sears, Prasad Sunkara, Ph.D., and Robert G. McNeil,

Respondents.

JUDGMENT

Defendants MAXIM PHARMACEUTICALS, INC. ("MAXIM"), KURT GEHLSEN ("GEHLSEN"), and LARRY STAMBAUGH ("STAMBAUGH'), have petitioned this Court to confirm the American Arbitration Association's Interim Decision and Final Award dated June 18, 2003 and September 30, 2003 respectively (the "Arbitration Award"). After review of the papers submitted, and consideration of the arguments for and against such confirmation, this Court hereby GRANTS Defendants' Petition to Confirm the

Arbitration Award and enters judgment in favor of MAXIM, GEHLSEN and STAMBAUGH and against Plaintiffs/ Respondents 3i Bioscience Investment Trust PLC, Crosspoint Venture Partners 1997, L.P., SBIC Partners II, L.P., Domain Partners III, L.P., DP III Associates, L.P., Domain Partners IV, L.P., DP IV Associates, L.P., Sanderling Ventures Partners IV, L.P., Sanderling IV Limited, L.P., Sanderling IV Biomedical, L.P., Sanderling [Feri Trust] Venture Partners IV, G.P., Sanderling Venture Partners IV Co-Investment Fund, L.P., Sanderling Venture Biomedical Partners Co-Investment Fund, L.P. (aka Sanderling IV Biomedical Co-Investment Fund, L.P.), Sanderling IV Venture Management, G.P., Eckard Weber, M.D., Fred Middleton, F. Richard Nichol, Ph.D., Richard Canote, Jeff Vick, Marvin E. Rosenthale, Ph.D., Lowell Sears, Prasad Sunkara, Ph.D., and Robert G. McNeil (collectively, "Plaintiffs/Respondents"). Therefore,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the Arbitration Award is confirmed. Plaintiffs/Respondents' claims are denied, and Plaintiffs/ Respondents shall take nothing from any of the Defendants. Defendants, as prevailing parties, shall recover from Plaintiffs/Respondents 3i Bioscience Investment Trust PLC, Crosspoint Venture Partners 1997, L.P., SBIC Partners II, L.P., Domain Partners III, L.P., DP III Associates, L.P., Domain Partners IV, L.P., DP IV Associates, L.P:, Sanderling Ventures Partners IV, L.P., Sanderling IV Limited, L.P., Sanderling IV Biomedical, L.P., Sanderling [Feri Trust] Venture Partners IV, G.P., Sanderling Venture Partners IV Co-Investment Fund, L.P., Sanderling Venture Biomedical Partners Co-Investment Fund, L.P. (aka Sanderling IV Biomedical Co-Investment Fund, L.P.), Sanderling IV

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Venture Management, G.P., Eckard Weber, M.D., Fred Middleton, F. Richard Nichol, Ph.D., Richard Canote, Jeff Vick, Marvin E. Rosenthale, Ph.D., Lowell Sears, Prasad Sunkara, Ph.D., and Robert G. McNeil $922,779.50 as their reasonable attorneys fees and costs incurred in connection with the arbitration.

DATED: 12/23/03

S. CHARLES WICKERSHAM

S. CHARLES WICKERSHAM
JUDGE OF THE SUPERIOR COURT

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AMERICAN ARBITRATION ASSOCIATION
COMMERCIAL ARBITRATION TRIBUNAL

Case No. 73 Y 168 00359 02 ARC

Arbitration Between

3i Bioscience Investment Trust PLC, Crosspoint Venture Partners 1997, SBIC Partners II, LP, Domain Partners III, LP, DP III Associates, LP, Domain Partners IV, LP, DP IV Associates, LP, Sanderling Ventures Partners IV, LP, Sanderling IV Limited, LP, Sanderling IV Biomedical, LP, Sanderling (Feri Trust) Venture Partners IV, Sanderling Venture Partners IV Co-Investment Fund, Sanderling Venture Biomedical Partners Co-Investment Fund, LP., Sanderling IV Venture Management, Eckard Weber, M.D., Fred Middleton, F. Richard Nichol, Ph.D., Richard Canote, Jeff Vick, Marvin E. Rosenthale, Ph.D., Lowell Sears, Prasad Sunkara, Ph.D., and Robert G. McNeil,

Claimants,

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and

Maxim Pharmaceuticals, Inc., Kurt Gehlsen,
and Larry Stambaugh,

Respondents.

FINAL AWARD

WE, THE UNDERSIGNED ARBITRATORS, having been designated in accordance with the arbitration agreement entered into by the parties hereto dated June 2, 2000, having been sworn, having heard the proofs and allegations of the parties and having previously rendered an Interim Decision dated June 18, 2003 (the "Interim Decision"), hereby AWARD as follows.

The Interim Decision is incorporated herein by this reference.

Claimants shall recover nothing from all or any of the Respondents.

Respondents, having been determined to be the prevailing party in this arbitration, shall recover from Claimants and are hereby awarded Eight Hundred Twenty Thousand Three Hundred Thirty Six Dollars and No Cents ($820,336.00) as and for, which the Panel finds to be, their reasonable attorneys' fees incurred in connection with this arbitration commencing with Respondents' receipt of the Demand for Arbitration. Respondents shall also recover from Claimants and are hereby awarded One Hundred Two Thousand Four Hundred Forty Three Dollars and Fifty Cents ($102,443.50)

as and for their costs and expenses exclusive of the arbitrators' compensation and expenses which are allocated below.

The administrative fees of the American Arbitration Association (the "Association") totaling $27,000 shall be borne by Claimants and previously paid the Association.

The compensation and expenses of the Arbitrators totaling $78,326.25 shall be borne equally by the parties, 50% by Claimants and 50% by Respondents, and deducted from deposits previously advanced the Association.

Respondents' request for interest on attorneys' fees, costs and expenses is DENIED.

This Final Award is in full settlement of all claims submitted to this arbitration.

This Final Award may be executed in any number of counterparts, each of which shall be deemed an original, and all of which shall constitute together one and the same instrument.

Dated: September 30, 2003

s/ Bruce W. Belding

s/ Richard G. Duncan, Jr.

s/ John J. McCauley

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AMERICAN ARBITRATION ASSOCIATION
COMMERCIAL ARBITRATION TRIBUNAL

Case No. 73 Y 168 00359 02 ARC

Arbitration Between

3i Bioscience Investment Trust PLC, et al.,

Claimants,

and

Maxim Pharmaceuticals, Inc., et al.,

Respondents.

INTERIM DECISION

WE THE UNDERSIGNED ARBITRATORS, having been designated in accordance with the arbitration agreement entered into by the parties hereto dated June 2, 2000, having been sworn and having heard the proofs and allegations of the parties, hereby render this Interim Decision.

The Parties. Claimants are 3i Bioscience Investment Trust PLC, Crosspoint Venture Partners1997, SBIC Partners II, LP, Domain Partners III, LP, DP III Associates, LP, Domain Partners IV, LP, DP IV Associates, LP, Sanderling Ventures Partners IV, LP, Sanderling IV Limited, LP, Sanderling IV Biomedical, LP, Sanderling (Feri Trust) Venture Partners IV, Sanderling Venture Partners IV Co-Investment Fund,

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Sanderling Venture Biomedical Partners Co-Investment Fund, LP, Sanderling IV Venture Management, Eckard Weber, M.D., Fred Middleton, F. Richard Nichol, Ph.D., Richard Canote, Jeff Vick, Marvin E. Rosenthale, Ph.D., Lowell Sears, Prasad Sunkara, Ph.D. and Robert G. McNeil (added pursuant to intervention authorized herein) and are collectively referred to as "Claimants" herein unless other designation is deemed appropriate or necessary. Respondents are Maxim Pharmaceuticals, Inc. ("Maxim"), Kurt Gehlsen, Ph.D., ("Dr. Gehlsen") and Larry Stambaugh and are collectively referred to as "Respondents" herein unless other designation is deemed appropriate or necessary.

The Arbitration. This arbitration was initiated by Claimants' Demand for Arbitration dated August 21, 2002 (the "Demand"). Respondents submitted their answering statement ("Response to Demand for Arbitration") dated September 12, 2002. The arbitration was conducted in San Diego, California on May 5, 6, 7, 8, 9, 12 and 13, 2003 before the undersigned (the "Panel"). Claimants were represented by Robert W. Brownlie, Esq., Terry D. Ross, Esq. and Lindsay A. Llavern, Esq. of Gray Cary Ware & Freidenrich LLP. Respondents were represented by Charles H. Dick, Jr., Esq., Katherine A. Bacal, Esq. and Shannon D. Sweeney, Esq. of Baker & McKenzie. Pursuant to the parties' request, and as ordered by the Panel, this "Interim Decision contains(s) a summary of the Panel's reasoning and/or rationale underlying the award." Scheduling Order, December 23, 2002, (the "Scheduling Order"), p. 3.

Award. An Award will be entered in favor of Respondents. Claimants shall recover nothing. Respondents are deemed

the "prevailing party" and as such shall recover their reasonable attorneys' fees, costs and expenses. The compensation and expenses of the arbitrators shall be borne equally by the parties. 50% by Claimants and 50% by Respondents.

Motions. After the conclusion of testimony Respondents made oral motions to dismiss the claims of Claimants Richard Canote, Jeff Vick, 3i Bioscience Investment Trust PLC, Sanderling Venture Partners IV, LP, Sanderling IV Limited, LP, Domain Partners III, LP, DP III Associates, LP, Domain Partners IV, LP, DP IV Associates, LP, and Crosspoint Venture Partners 1997 or, as to certain of said Claimants, alternatively and at a minimum, that the preceedings be abated as to them. Claimants submitted briefs in opposition thereto on May 15; Respondents submitted a reply dated May 29, 2003. Claimants also submitted a motion for leave for Robert G. McNeil to intervene and to be joined as a Claimant: Respondents opposed that motion. Upon reviewing the arguments, and considering the oral and written submissions, Respondents' motions, and each of them, are DENIED, and Claimants' motion for intervention and joinder as a Claimant of Robert G. McNeil is GRANTED. Respondents also opposed the reception of certain declarations submitted by Claimants after conclusion of testimony; those objections are OVERRULED, and the declarations are admitted into evidence.

Reasoning and/or Rationale Underlying Award. Claimants, as former holders of stock and/or options in Cytovia, Inc. ("Cytovia"), seek compensatory damages in the amount of $29,504,870 and $8,536,203 in interest, for a total

of $38,041,073 (Claimant's Brief Regarding. . . Damages Calculations, May 15, 2003), on theories of fraud, negligent misrepresentation and breach of contract, allegedly arising from, and caused by Claimants' justifiable reliance on Respondents' misrepresentations and/or omissions to state material facts regarding Maxim's Phase III clinical trial of and its application for approval by the Food & Drug Administration ("FDA") of its cancer drug, Maximine, and about Maxim's relations with the FDA regarding tis clinical trial and pending application in connection with Claimants' agreement to exchange their stock in Cytovia for stock in Maxim, and an allegedly false statement in the Information Statement prepared pursuant to the Merger Agreement. (Demand; Arbitration Brief of Cytovia Stockholders ["Claimants' Arbitration Brief"])

Claimants hold substantially all of the shares in Maxim which they acquired as a result of the merger of Maxim and Cytovia. They therefore stand to reap and benefits that may accrue to such shareholders if the FDA in the future approves Ceplene, Maxim's successor drug to Maximine. Claimants, however, allege that they were defrauded in their acquisition of shares in Maxim, and in agreeing to transfer their shares and/or options in Cytovia for shares and/or options in Maxim, as a result of alleged misrepresentations by the Respondents which, Claimants allege, reduced the value of the stock which they acquired by $24.66 per share and $24.65 per option as of the date of the merger excluding any sold for a profit, for their total compensatory damages claim of $29,504,870.

We do not reach the issue of damages, as we conclude that Claimants have not sustained their burden of proof that

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(1) Respondents defrauded them or that Claimants justifiably relied on any alleged misrepresentations by Respondents, (2) Respondents negligently misrepresented any fact or that Claimants justifiably relied on any representation allegedly made without reasonable basis, or (3) Respondents breached any contract, representation or warranty to Claimants.

It is undisputed that Claimants, particularly those who were in executive positions and/or otherwise involved in the management of Cytovia, are highly educated, sophisticated business persons with considerable breadth and significant depth of experience in clinical drug development, cancer treatment and the biotechnical industry. Several also have had considerable experience with clinical trials and in processing drug applications through the FDA.

Cytovia was formed in 1998. It was initially financed by $10,000,000 in venture capital and received an additional capital infusion of $2,000,000 in July 1998. It, not unlike similar companies, had a high cash burn rate. By April 1999 Cytovia had experienced difficulty in forming significant partner collaborations and/or establishing financially profitable licensing agreements, and was focusing on raising capital. Cytovia also refocused its business direction more toward clinical research and development than on its prior emphasis on screening and testing, which involved higher costs of doing business. By mid-1999 it needed another round of financing or to be acquired, according to its internal reports and documents. By the fall of 1999 it concluded that it might not be sufficiently attractive to potential investors, so it focused more on being acquired. It experienced two unsuccessful merger efforts (GPC Biotech AF and Matrix

Pharmaceuticals). In December 1999 Cytovia's venture capital owners infused an additional $3,000,000 into it. In February 2000 its management reported that its current cash was projected to only last through June. In March Cytovia was introduced to Maxim. Notwithstanding the characterization that Maxim wanted to acquire Cytovia to give it "something to fall back on after its NDA for Maximine was rejected" (Claimants' Arbitration Brief, 33:24), the Panel concludes from the evidence that the introduction to Maxim was a fortuitous opportunity for Cytovia, with which Claimants - in light of Cytovia's financial situation and needs at the time - were understandably excited and enthusiastic due in large part to Maxim's strong capitalization and, as a potential bonus, Maxim's promising cancer drug Maximine which was undergoing a Phase III clinical trial in its FDA approval process.

The stock-for-stock merger of Maxim and Cytovia occurred in June 2000. In December 2000 the FDA's Oncologic Drug Advisory Committee ("ODAC") rejected Maxim's new drug application ("NDA") regarding Maximine. The value of Maxim's shares and options dropped immediately thereafter. Claimants contend that their agreement to merge, and to transfer their shares and options in Cytovia for shares and options in Maxim, were procured as a result of their justifiable reliance on intentional or negligent misrepresentations by Respondents as to the history, status and results of Maxim's Phase III clinical trial and its application with the FDA for approval of Maximine.

As to Claimants' claim of fraud (intentional misrepresentation and/or omission), while many references and

authorities cited by Claimants are to securities laws and securities fraud cases under various statutes, it is undisputed that this is a case and claim alleging common law fraud. The claim of fraud fails since the Panel concludes that Respondents did not knowingly or intentionally make any misrepresentations to Claimants or their representatives and the Claimants did not justifiably rely on the representations that they claim were false. Based on the Panel's assessment of the evidence and the relative credibility of the witnesses and all circumstances surrounding the transaction and Respondents' actions in connection with the clinical trial and its dealing with - and anticipation of favorable action by - the FDA, the Panel concludes that Respondents had a good faith belief that Maximine would receive some form of approval from the FDA. The requisite element of intent, or *scienter,* essential to establish a claim of fraud is therefore lacking. Respondents' conduct before and after the FDA/ ODAC rejection of Maxim's NDA is consistent with Respondents' good faith belief that it would be approved, e.g., substantial investment in future plans for its marketing, hiring additional personnel, further investments, stock gifts to family, etc., and inconsistent with knowledge that the NDA would be disapproved.

As to Claimants' claim of negligent misrepresentation, while there was evidence of certain language which, in hindsight, may have been communicated to Claimants and/or their representatives with more precision, the Panel concludes that Respondents had a good faith basis for, and reasonable belief in the truth of, the statement they made to Claimants and/or their representatives as of the dates that they were made. It is conceded that Claimants' "claim for negligent

misrepresentation is supported by exactly the same facts as the fraud claim." (Claimants' Arbitration Brief, 46:88-9) It is further conceded that the only difference between claims of fraud and of negligent misrepresentation is that "... whereas fraud requires the defendant to know the falsity of his representation, negligent misrepresentation only requires that the defendant lack a reasonable ground to believe it to be true." (Id., 46:6-7) Based on the Panel's review of the evidence, conflicting testimony and assessment of the relative credibility of the witnesses and related factors, the Panel concludes that Respondents did have reasonable grounds for the statements and representations they made to Claimants and/or their representatives.

Claimants' claim of fraud and negligent misrepresentation also fail since the Panel concludes that Claimants did not sustain their burden of proof that they justifiably relied on the alleged misrepresentations. It is undisputed that justifiable reliance on alleged misrepresentations (intentional or negligent) is an essential element of each claim. (Claimants' Arbitration Brief, 35:14: Respondents' Arbitration Brief, 25:16-28:18) Here, Claimants were enthusiastic about and anxious to expedite conclusion of the merger with Maxim. Cytovia had scientists and executives with substantial relevant experience in clinical drug development, cancer treatment, the biotechnology industry, clinical trials and processing NDAs through the FDA in addition to its sophisticated business-experienced investors.

Claimants also engaged Randolph C. Steer, M.D., Ph.D., and extremely well-qualified, experienced and highly intelligent individual who had conducted 20-25 due diligence

investigations for one of Cytovia's primary investors (Domain Associates, two of whose funds were investors in Cytovia) previously, "to perform regulatory due diligence on Maxim and its Phase III clinical trial." (Claimants' Arbitration Brief, 9:3-4) In its engagement letter to Dr. Steer, Domain stated, in part, that "the consideration to be used for the purchase of Cytovia will likely be Maxim stock (so) it is essential for Domain to analyze the drivers that are going to affect Maxim's stock price over the next few years," noted that "Maxim's share price has increased five-fold since November 1999," stressed Domain's concern ("main issue") over any "negative impact . . . on the stock price" and asked for "a comprehensive clinical and regulatory assessment of Maxim's lead product, Maximine." The Domain letter also provided a detailed list of bullet-point items for Dr. Steer to address. (Exh. 162) Dr. Steer forwarded that letter to Maxim.

Dr. Steer wrote to Maxim's CEO, in part, that "following my review of (Investigator Brochure, general public information on Maxim and Maximine, key phase 3 protocols and a brief reply to each question referenced in Domain letter of April 3, 2000 [Exh. 162]). I will approach Kurt Gehlsen, CTO, for the 2 hour overview and thereafter visit the company for review of FDA correspondence and other sensitive documentation and/or issues." (Exh. 164) Dr. Steer received and reviewed materials from Maxim and conducted independent research. Dr Steer attended, with other Cytovia executives and scientists (Dr. Weber, Dr. Sunkara, Mr. Vick and Mr. Canote) a meeting at Maxim on May 8, 2000. Dr. Gehlsen gave a presentation (Exh. 220, Power Point portions), and Dr. Steer testified that he (Dr. Steer) asked several questions during the presentation all of which Dr.

Gehlsen answered. Dr. Steer was favorably impressed with the presentation, particularly regarding the progress and status of the Phase III trial and the FDA application/process. Dr. Steer testified that at the end of the presentation he asked Dr. Gehlsen for "your entire regulatory/FDA file," and that Dr. Gehlsen agreed and brought him "a file" of 20-30-40 pages in size and in response to Dr. Steer's question if this was "the entire regulatory file." Dr. Gehlsen responded, "Yes." Dr. Steer reviewed the file and testified that he said and concluded that the file was "really clean" and that he saw "no land mines in here." Dr. Steer testified that from his extensive experience with regulatory files or logs, some were huge, some were small, but it was "more normal" that the regulatory log or file would be comprised of more that 20-30-40 pages of documents. Dr. Steer did not ask for a copy of the file that he was shown. He then joined Drs. Weber and Sunkara and Mr. Canote at lunch, feeling that he had all that he needed for his report, and gave a glowing oral report of his assessment of Maxim, Maximine, the clinical trial and prospects of some form of FDA approval.

Dr. Steer then prepared and submitted his due diligence report dated May 10, 2000. (Exh. 212) In that report, in part, Dr. Steer reported that while he "did not review original data (or) conduct a typical audit of the data (he) reviewed an extensive volume of material provided directly by the company or obtained from other sources (and) extensive published manuscripts supporting the scientific rationale for this product." (pp. I-2) He also reported, in response to Domain's bullet-point question "Are the trial protocols properly designed?" that "I studied these protocols and the Investigator's Brochure in detail (and they) are very

intelligently designed. " He reported that "I also spent a lot of time in statistical issues related to the Phase 3 melanoma trial (and concluded) the statistical design is acceptable." Responding to Domain's bullet-point regarding objectivity and clarity of the clinical trial endpoints, Dr. Steer said, in part, "I consider these results to be historic in their significance." In response to the bullet point "The protocol, FDA minutes and statistical plan," Dr. Steer said, "The protocols are excellently crafted and the statistical plan is solid. *I reviewed the entire regulatory log from January 1997 until April 2000 and I do not see any landmine or smoking gun related to regulatory issues. Moreover, it is clear to me that the company understands the nature of FDA communications*." (Id., p. 4, Italics added.)

Dr. Steer testified that he uses the terms "log" and "file" in this context synonymously or interchangeably. Dr. Steer testified that he was not shown a multi-page document entitled "IND 52.603 Chronological History" (Exh. 349) on May 8, 2000, and that if he had seen it "Multiple points would have exploded in my mind," and that first entry on it of "1/31/97" would have been inconsistent with the slide in Dr. Gehlsen's Power Point presentation that the original protocol was submitted in July 1997. He further testified that he had not seen a copy of Maxim's letter to the FDA dated January 31, 1997 (Exh. 6) until April 2003, that it was not in the file which he was shown on May 8, 2000, and that if it had been in the file it would have been inconsistent with what Dr. Gehlsen had said about the initial submission having been in July 1997. Since the uncontradicted testimony is that all correspondence with the FDA regarding the Maximine application was logged in the chronological history (Exh.

349), and the earliest reference therein is to activity or correspondence in January 1997, a question arises as to what Dr. Steer meant by having "reviewed the entire regulatory log from January 1997. . . ." Only one document seems to have that characteristic, and Dr. Gehlsen testified that he caused a copy of it (Exh. 349) to be provided for Dr. Steer on May 8, 2000. Dr. Steer, as noted above, did not request or obtain a copy of the file he was furnished on May 8, 2000, and he testified that sometime before December 2000 (prior to the ODAC review/rejection) he destroyed all documents in his files relating to this assignment (his notes from the May 8, 2000 meeting, the journal articles and the materials that Mr. Stambaugh, Maxim's CEO, had sent him) along with "hundreds of thousands" of other documents that he had been storing. The Panel therefore questions the accuracy of Dr. Steer's recollection of what he was shown on May 8, 2000. Also in attendance at the May 8, 2000 meeting were Drs. Weber and Sunkara and Messrs. Vick and Canote, all of whom had varying degrees of experience with clinical trials and with the FDA; they, as well as Dr. Steer, could have pursued issues and questions further, and they all knew of uncertainties inherent in any FDA application (". . . approval is never guaranteed." Dr. Steer, Exh. 212, p 4, par. 14) and that usually regulatory logs/files are comprised of many many documents or boxes of documents, filings, submissions, amendments, reports, minutes, etc., and not confined to a 'file' of 20-30-40 pages. Dr. Weber also testified that he independently conducted some investigation and due diligence. The Panel is not persuaded that Respondents hindered any aspect of Claimants' due diligence investigation or concealed any information.

Appendix B

Respondents were enthusiastic and anxious over the merger and the opportunities it presented. Claimants made a business decision to proceed and were afforded access to all relevant information. They did not justifiably rely on any alleged misrepresentations.

Claimants' claim of breach of contract, warranty and/or representation, which asserts that the statement in the Information Statement that the Phase III Clinical trial "results demonstrated a statistically significant increase in survival for patients with the combination of Maximine plus interleukin-2 (IL-2)" is false and therefore constitutes a breach of warranty and representation, is rejected. The statement is not false. Maxim's trial *did* demonstrate *a* statistically significant increase – in the liver mets end point group (one of two end points).

Attorneys' Fees, Costs and Expenses. The Merger Agreement provides, in part, that "The prevailing party in any such arbitration (of disputes not successfully resolved pursuant to Section 10.18) shall be entitled to recover from the other party the reasonable attorneys' fees, costs and expenses incurred by such prevailing party in connection with such arbitration." (Demand, Exh. B thereto, p. 46, Par. 10.19) Respondents are deemed to be the prevailing party for this purpose and, as such, shall recover from Claimants their reasonable attorneys' fees, costs and expenses ("Fees and Costs") incurred in connection with this arbitration. Respondents shall serve and file, and cause to be delivered to the Panel by overnight delivery only, their application for Fees and Costs not later than ten (10) business/court days from the date of this Interim Decision. Claimants may serve

and file their comments/opposition ("Opposition") thereto not later than ten (10) business/court days from the date of service of Respondents' application. The issue of the amount of Fees and Costs to be awarded will be decided solely upon the written submissions and without argument or hearing. In their application and Opposition the parties shall address the issue of whether "the cost of arbitrators" in the Merger Agreement (Par. 10.19, p. 46) includes the fees and costs of the American Arbitration Association in addition to the compensation and expenses of the arbitrators or whether such fees and expenses are "costs" or "costs and expenses" potentially recoverable by the prevailing party.

Closing of Hearing. The hearing will be closed upon the service and filing of Claimants' Opposition or, if no Opposition is filed then the hearing will be closed upon the date on which such Opposition was due. The Award will be due thirty (30) days from the date the hearing is closed.

Dated: June 18, 2003

s/ Bruce W. Belding

s/ Richard G. Duncan, Jr.

s/ John J. McCauley

Appendix B

AMERICAN ARBITRATION ASSOCIATION
COMMERCIAL ARBITRATION TRIBUNAL

Case No. 73 Y 168 00369 02 ARC

Arbitration Between

3i Bioscience Investment Trust, PLC, et al.,

Claimants,

and

Maxim Pharmaceuticals, Inc., et al.,

Respondents.

ORDER DENYING MOTION FOR RECONSIDERATION OR AMENDMENT OF INTERIM DECISION

The Panel has reviewed, carefully considered and conferred regarding Claimants' Motion dated July 3, 2003 for Reconsideration or, in the Alternative, Amendment of the Interim Decision issued herein dated June 18, 2003. After such consideration, the Panel orders that the motion be, and it hereby is, DENIED.

Dated: July 15, 2003

s/ Bruce W. Belding
Bruce W. Belding, Chair,
For, on behalf of and with
the authority and approval
of the Panel

Appendix B

AMERICAN ARBITRATION ASSOCIATION

Case No. 73 Y 168 00359 02 ARC

3I Bioscience Investment Trust PLC, et al.,

v.

Maxim Pharmaceuticals, Inc., et al.

ORDER REGARDING ATTORNEYS' FEES, COSTS AND EXPENSES

After the Panel rendered its Interim Decision dated June 18, 2003 and its Order Denying Motion for Reconsideration or Amendment of Interim Decision dated July 15, 2003, Claimants submitted their Opposition to Respondents' then-pending Application for Fees and Costs (the "Application"). The Panel then requested submissions regarding certain arguments raised in the Opposition (Memorandum to counsel, July 22, 2003). The parties then submitted (a) Respondents' Supplemental Submission and Declaration of Katherine A. Bacal in Support of Application for Fees and Costs dated July 29, 2003 and (b) Claimants' Reply to Respondents' Supplemental Submission Etc. dated August 4, 2003.

The Panel has reviewed, considered and deliberated regarding the foregoing and related submissions and arguments, has reviewed the documents and records from the superior court and court of appeal proceedings that preceded this arbitration, has re-reviewed the applicable provisions of the Merger Agreement and orders as follows:

Appendix B

Respondents, as the prevailing party (see Interim Decision), are entitled to recover, and shall be awarded, their reasonable attorneys' fees, costs and expenses incurred in connection with the arbitration, commencing with Respondents' receipt of Claimants' Demand for Arbitration, including the proceedings to compel arbitration and including the mediation, through the post-hearing briefing on attorneys' fees, costs and expenses. (Preliminarily it appears to the Panel that pre-arbitration fees and expenses of $331,206 shall, as a result of this decision, be deducted from Respondents' application for fees, costs and expenses. Application, p. 3, fn. 3) Inasmuch as Respondents' initial application included fees and costs through May 31, 2003 (Application, p. 4, fn. 6), Respondents are granted to and including August 21, 2003 to submit their supplemental application for fees, costs and expenses incurred since May 31, 2003. Claimants shall submit any comments and/or opposition – limited to addressing the numbers, amounts sought, claimed 'reasonableness', etc. and not underlying objections to the bases for the application) – on or before September 3, 2003. The issue will then be deemed submitted to the Panel for decision solely upon the written submissions.

Dated: August 11, 2003

s/ Bruce W. Belding
Bruce W. Belding, Chair, for the Panel

APPENDIX C — ORDER GRANTING DEFENDANTS' PETITION TO COMPEL ARBITRATION DATED JANUARY 15, 2002

SUPERIOR COURT OF CALIFORNIA,
COUNTY OF SAN DIEGO
CENTRAL DIVISION

CASE NO. GIC 776631

CROSSPOINT VENTURE PARTNERS 1997, et al.,

Plaintiffs,

v.

MAXIM PHARMACEUTICALS, INC., et al.,

Defendants.

ORDER GRANTING DEFENDANTS' PETITION TO COMPEL ARBITRATION

DATE: January 11, 2002
TIME: 10:30 a.m.
DEPT: 73
JUDGE: S. Charles Wickersham

COMPLAINT FILED: October 19, 2001

Defendant's Petition to Compel Arbitration came on for oral argument in Department 73 of the above-entitled Court, the Honorable S. Charles Wickersham presiding. Robert W. Brownlie and Kathryn B. Riley of Gray Cary appeared on

behalf of the Plaintiffs and Charles H. Dick, Jr. and Katherine A. Bacal of Baker & McKenzie appeared on behalf of Defendants.

After having considered oral arguments of counsel, the papers filed in connection with the petition, as well as the entire file in this matter, and for good cause appearing,

IT IS HEREBY ORDERED that the telephonic ruling granting Defendants' petition to compel arbitration is confirmed, Defendants' petition is granted and the action is stayed pending arbitration.

IT IS SO ORDERED.

Dated: 1/15/02 s/ S. Charles Wickersham
JUDGE OF THE SUPERIOR COURT

Appendix C

SUPERIOR COURT
San Diego County, State of California

The following is a TELEPHONIC, ruling for 1/4/02, Department 73, the Honorable S. CHARLES WICKERSHAM presiding.

Case Number GIC776631

Defendants' motion to compel arbitration is granted and the action is stayed pending arbitration. Plaintiffs are third party beneficiaries of the Merger Agreement (see Section 1.5). Therefore, plaintiffs are bound by the arbitration clause even though most of them did not sign it. If no party requests oral argument within two court days after the tentative ruling is announced, then the tentative ruling becomes the final order of the court. To request oral argument, contact the Court by phoning (619)685-6119. When reserving time for oral argument, the requesting party must be prepared to identify precisely which issues are to be argued and also to prepare written notice to the Court and the opposing party upon obtaining the reservation. Oral argument once reserved will calendared to be heard on January 11, 2002 at 10:30 a.m. in Department 73.

APPENDIX D — ORDER OF THE SUPREME COURT OF CALIFORNIA DENYING PETITION FOR REVIEW FILED FEBRUARY 23, 2005

SUPREME COURT OF CALIFORNIA

S130469

CROSSPOINT VENTURE PARTNERS 1997 et al.,

Plaintiffs and Appellants,

v.

MAXIM PHARMACEUTICALS INC. et al.,

Defendants and Respondents;

ROBERT G. MCNEIL,

Intervenor and Appellant.

February 23, 2005, Filed

OPINION: Petition for review & publication request denied.

APPENDIX E — EXCERPTS FROM AGREEMENT AND PLAN OF MERGER AND REORGANIZATION AMONG: MAXIM PHARMACEUTICALS, INC., A DELAWARE CORPORATION; M-80 ACQUISITION CORP., A DELAWARE CORPORATION; AND CYTOVIA, INC., A DELAWARE CORPORATION DATED AS OF JUNE 2, 2000

* * *

Section 10.18. Negotiation of Dispute. If a dispute arises between the parties relating to the interpretation of performance of this Agreement," [the parties shall attempt to negotiate a resolution; if such resolution is not successful] "such dispute may be resolved through arbitration pursuant to Section 10.19.

Section 10.19. Arbitration. Disputes that have not been successfully resolved pursuant to Section 10.18 . . . shall be settled by a panel of three arbitrators with such arbitration to be held in San Diego, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof.

* * *

The arbitrators shall make their decision in accordance with the terms of this Agreement and applicable law.

* * *

Appendix E

The prevailing party in any such arbitration shall be entitled to recover from the other party the reasonable attorneys' fees, costs and expenses incurred by such prevailing party in connection with such arbitration. The decision of the arbitrators shall be final and may be sued on or enforced by the party in whose favor it runs in any court of competent jurisdiction at the option of the successful party. The rights and obligations of the parties to arbitrate any dispute relating to the interpretation and performance of this Agreement or the grounds for the termination thereof, shall survive the expiration or termination of this Agreement for any reason.

* * * *

APPENDIX F — STATUTORY PROVISIONS INVOLVED

9 U.S.C.S. § 1 (2005)

§ 1. . . . "commerce" defined; exceptions to operation of title

> . . . "commerce", as herein defined, means commerce among the several States or with foreign nations, ...

9 U.S.C.S. § 2 (2005)

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, . . . or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Supreme Court, U.S.
FILED
AUG 2 - 2005
OFFICE OF THE CLERK

(3)

No. 04-1590

IN THE

Supreme Court of the United States

MAXIM PHARMACEUTICALS, INC.,
LARRY STAMBAUGH and KURT GEHLSEN,

Petitioners,

v.

CROSSPOINT VENTURE PARTNERS 1997, L.P., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEAL OF CALIFORNIA,
FOURTH APPELLATE DISTRICT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. In an unpublished opinion, a California appellate court applied settled Ninth Circuit law to find that the scope of a narrow arbitration provision precluded compelled arbitration of tort claims that arose before the contract was formed. It decided no federal question nor did it create any conflict in federal law. Did the state court err in ruling under Ninth Circuit law that the scope of the narrow arbitration provision precludes compelled arbitration of tort claims that arose before the contract was formed?

2. Respondents held shares in Cytovia, Inc. (Cytovia), which was a party to the contract at issue in this case. The contract enumerates its three parties, and does not include respondents. Beyond that (with the exception of two specific provisions not pertinent here) the contract expressly provides that there are no third party beneficiaries. If this Court was otherwise inclined to grant the petition, does respondents' status as mere incidental beneficiaries to the contract—against which the arbitration provision could not be enforced in any event—render this case an inappropriate one to decide the first question?

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Crosspoint Venture Partners 1997, L.P., et al. (Cytovia Stockholders) urge that the petition for certiorari be denied. In this opposition brief, "petitioners" or "Maxim" refers to Maxim Pharmaceuticals, Inc., Kurt R. Ghelsen, and Larry Stambaugh, unless otherwise indicated.

STATEMENT OF THE CASE

A. Maxim's Fraud to Obtain Approval of the Merger.[1]

Cytovia was a San Diego-based, privately-held biotechnology company. (Petitioner's Appendix [Pet. App.] 4a.) In June 2000, Maxim, a publicly-traded company, acquired Cytovia through a merger in which Cytovia stockholders received Maxim stock in exchange for their Cytovia stock. (*Id.*)

Central to the merger was Maxim's representations of extremely positive Phase III clinical trial results in March 2000 for Maxamine, a new drug that Maxim touted as its most promising one. (*Id.*) Maxim represented that when Maxamine was used with another drug, Maxamine resulted in a statistically significant increase in survival for patients with metastatic melanoma. (*Id.*)

The Phase III clinical trial was so critical to the merger discussions that in April 2000 Cytovia Stockholders hired a consultant to review the information provided by Maxim concerning it. (1 Appellants' Appendix [A.A.] 7.) In early May 2000, Maxim issued a press release announcing very

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[1] This summary, as the court of appeal's opinion notes, is based primarily on the Cytovia Stockholders' complaint. (Pet. App.4a.)

positive results from the Phase III clinical trials.: (1 A.A. 7; 2 A.A. 245.)

The Cytovia Stockholder's consultant, Cytovia's founder, and other board members met with Maxim's Chief Scientist Gehlsen (among others). (1 A.A. 8.) The consultant asked—more than once—for Maxim's entire regulatory file concerning the Phase III clinical trial and specifically all Food & Drug Administration (FDA) correspondence. (*Id.* at 7-8.) Gehlsen gave the consultant a file with 15 to 20 pages in it. (*Id.* at 8.) The file contained no negative comments from the FDA about the clinical trial. (*Id.*) When the consultant asked Gehlsen if he could review the original data from the clinical trial, Gehlsen said there was no need, and misrepresented (among other things) that the clinical trial was randomized, the treatment arms of the study were homogeneous, and that there were no discordances or skewedness between them. (*Id.*)

Finally, in early June 2000, to induce the Cytovia Stockholders to approve the proposed merger, Maxim issued another false press release making misrepresentations similar to those described above. (1 A.A. 9; 2 A.A. 253.) A week later, Maxim distributed to Cytovia Stockholders an Information Statement that reiterated its misrepresentations about the March 2000 Phase III clinical trial of Maxamine as a treatment for malignant melanoma. (1 A.A. 9-10; 2 A.A. 258, 265.)

B. The Merger and Merger Agreement.

In June 2000, in reliance on Maxim's misrepresentations and omissions, the Cytovia Stockholders approved the merger. (Pet. App. 4a-5a, 12a; 1 A.A. 9-10.)

The Merger Agreement (Merger Agreement or Agreement) expressly recited that its parties were Maxim, Maxim's acquisition company M-80 Acquisition Corp. (M-80), and Cytovia. (Pet. App. 4a-5a.) The Merger Agreement also expressly addressed the rights of third parties such as the Cytovia Stockholders. Section 10.14 provided that "[e]xcept for the provisions of Sections 1.5 and 1.6, none of the provisions is intended to provide any rights or remedies to any Person other than the parties hereto." (*Id.* at 5a.) The Agreement's arbitration clause required "the parties" to arbitrate disputes that related to "the interpretation or performance of" the Agreement. (*Id.* at 5a.)

Six months after the merger in December 2000, in a rare unanimous vote, the FDA denied Maxim's new drug application for Maxamine. (Pet. App. 5a; 1 A.A. 10; 2 A.A. 332, 402-03.) The FDA strongly criticized Maxim's Phase III clinical trial. (2 A.A. 337-43.) It described in detail a history of written and oral communications between the FDA and Maxim dating to April 1997 in which the FDA was highly critical of the clinical trial and which showed Maxim's application was doomed to fail. (1 A.A. 14; 2 A.A. 337-43.) None of these communications had been provided to the Cytovia Stockholders or their consultant. (1 A.A. 14, 15.) FDA statistical analyses also showed the trial failed to demonstrate a statistically significant increase in patient survival—directly contradicting Maxim's representations in press releases and the Information Statement. (2 A.A. 425-27; compare with 265.)

C. Procedural Summary.

In October 2001, the Cytovia Stockholders filed their complaint in California state court against Maxim, Stambaugh, and Gehlsen for fraud and negligent misrepresentation. (Pet. App. 5a.) The Cytovia Stockholders did not allege any contract-based claims. (*Id.*; 1 A.A. 1-21.)

Maxim petitioned the trial court to compel the Cytovia Stockholders to arbitration, contending they were bound by the arbitration provision even though they did not sign it. (Pet. App. 6a.) The Cytovia Stockholders argued in opposition that they were not parties to the Agreement nor were they its third party beneficiaries and, alternatively, that their tort claims did not relate to the interpretation or performance of the agreement. (*Id.* at 6a, 7a.) The trial court granted the petition, finding the Cytovia Stockholders were third party beneficiaries of the Agreement. (*Id.* at 6a.)

Once erroneously ordered to arbitrate their claims, the Cytovia Stockholders included among their arbitration claims a contract claim (over Maxim's objection), which the court of appeal found was merely an "effort to exhaust every reasonable means to obtain a recovery" and not, as Maxim asserted, a waiver of the Cytovia Stockholders' right to a jury trial. (Pet. App. 14a, 16a.) Ultimately, the arbitrators found against the Cytovia Stockholders and awarded almost a million dollars in attorneys' fees and costs against them. (3 A.A. 482-85.) The trial court confirmed the arbitration award and entered judgment for Maxim. (Pet. App. 7a.)

Without reaching the question whether the Cytovia Stockholders could be forced into arbitration, the court of appeal decided that their pre-contract tort claims:

> [D]o not involve a dispute relating to the interpretation of the agreement, nor do they involve a dispute relating to the performance of the executed agreement. We conclude that the claims arose from allegedly tortious conduct that commenced before the expressly identified parties—Maxim Pharmaceuticals, M-80, and Cytovia—executed the agreement, and thus do not relate to the performance of the executed agreement.

(*Id.* at 13a.) Maxim petitioned the California Supreme Court for review. Within a few days of Maxim's filing a reply brief, that court issued its order denying review, without indicating that any justice had voted to grant review. Maxim's petition to this Court is from that order.

II. THE PETITION FAILS TO MEET THE CRITERIA FOR CERTIORARI.

A. Nothing in This Case Fits Within the Rule 10 Criteria for Review of State Court Cases.

1. The California Court of Appeal's Decision Did Not Create a Conflict in Authority on an Important Federal Question.

Supreme Court Rule 10 identifies the two types of state court cases that can justify granting a writ of certiorari. Sup. Ct. R. 10(b), (c). The petition fits within neither of them.

Supreme Court Rule 10(b) provides that decisions of state courts of last resort that create a conflict in authority on an important federal question might justify review on a petition for a writ of certiorari. It is undisputed in this case that the court of appeal's unpublished decision creates no important federal conflict, for at least two reasons.

First, even if it created a conflict in federal law, the opinion is not published and thus affects only the parties to this case. Under California law, unpublished decisions are not citable as precedent, except by the parties for res judicata purposes. Cal. Rules of Court, Rule 977(a)-(b)(1).

Second, the opinion straightforwardly applies Ninth Circuit law on the question whether a narrow arbitration provision requiring the arbitration of parties' claims about the "interpretation or performance" of an agreement compels the arbitration of tort claims arising before the agreement was signed. This creates no federal conflict on its face, important or unimportant.

2. The Court of Appeal Did Not Decide an Important Federal Question.

Supreme Court Rule 10(c) provides that review may be justified on a petition for a writ of certiorari when a state court of last resort has decided an important federal question that has not been, but should be, decided by the Supreme Court. Again, as noted throughout this brief, the court of appeal's decision did nothing more than correctly apply settled Ninth Circuit law to the dispute between these parties—a decision that can affect no one other than the parties.

This case thus does not merit review under Supreme Court Rule 10 on any basis. The petition tries to create a (false) impression that this case somehow presents a question of conflicts in circuit courts of appeals by ignoring Supreme Court Rule 10 and by omitting two critical facts that render this case an inappropriate vehicle for considering any such conflict that might exist in another case. One is that the Merger Agreement specifically limits its arbitration provision to the named parties to the Agreement, which respondents are not. The other is that the agreement contains a third party beneficiary disclaimer clause, so even if (as the trial court but not the appellate court found) respondents would otherwise be the Agreement's third party beneficiaries, the parties' intent on the face of their contract was to exclude any such beneficiaries. In sum, the issues in the case depend upon the specific language of the contracting parties' Agreement and the unique factual scenario present here—a scenario the petition scarcely adverts to, let alone addresses. Nothing in the petition merits granting the writ petition.

B. The California Appellate Court Correctly Decided that the Cytovia Stockholders' Fraud Claims Were Not Arbitrable.

The California Court of Appeal's unpublished, unanimous decision correctly decided the Cytovia Stockholders' claims for fraud and negligent misrepresentation were not arbitrable under the narrow language of the Merger Agreement. (Pet. App. 10a.) Under California law, the scope of an arbitration provision rests solely upon the parties' contract. (Pet. App. 9a;

see also Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street, 35 Cal. 3d 312, 322–23 (1983)). Doubts about whether an arbitration clause applies to a particular dispute are to be resolved in favor of sending the parties to arbitration. (Pet. App. 9a.)

The appellate court correctly recognized, however, that "[t]here is no public policy favoring arbitration of disputes which the parties have not agreed to arbitrate." (*Id.* citing *Eng'rs & Architects Ass'n v. Cmty. Dev. Dept.*, 30 Cal. App. 4th 644, 653 (1994).) And, despite California's and the FAA's strong policies favoring arbitration, the "substantial right of a litigant to pursue claims in a judicial forum is not lightly deemed waived," and the general policies favoring arbitration cannot control over express contractual language showing parties have not elected to arbitrate a dispute. (Pet. App. 9a (citing *Mayhew v. Benninghoff*, 53 Cal. App. 4th 1365, 1371 (1997)).)

The Cytovia Stockholders do not dispute that scope clauses are generally construed liberally. The California appellate court properly applied Ninth Circuit law in determining the Cytovia Stockholders' tort claims are not arbitrable. (Pet. App. 10a–13a.) In *Mediterranean Enters., Inc. v. Ssangyong Corp.*, 708 F.2d 1458 (9th Cir. 1983), the court examined an arbitration clause providing that "any disputes arising hereunder or following the formation of joint venture shall be settled through binding arbitration." *Id.* at 1461 (finding "arising hereunder" synonymous with the narrow "arising under the agreement" language covering only disputes relating to interpretation and performance of the contract). The *Mediterranean* court, itself applying and

interpreting California law, held that disputes regarding "interpretation and performance" of the contract itself are expressly "intended to cover a much narrower scope of disputes." *Id.* at 1464. The court distinguished narrower clauses from those defining as arbitrable disputes "arising out of or relating to" an agreement—the standard language recommended by the American Arbitration Association (AAA). The court classified such language as "broad" and subject to more liberal application. *Id.*

The *Mediterranean* court found that omitting the broad language, as the Merger Agreement does, to be "significant." *Id.* Thus, notwithstanding the strong presumption in favor of arbitrating disputes, "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to submit." *Id.* at 1463, citing *United Steel Workers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960). Accordingly, Mediterranean concluded that the conspiracy and inducement claims alleged activity outside the scope of the arbitration clause. *Mediterranean Enters., Inc.*, 708 F.2d at 1464–65.

Maxim relies heavily on *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 396 (1967), citing it for the proposition that, in interpreting the scope of a "broad" arbitration provision, this Court expressly recognized that fraudulent inducement claims should be arbitrated when "there is no evidence that the contracting parties intended to hold that issue from arbitration." (Maxim Pet. at 7, 11.) Maxim attempts to create conflict where none exists. The clause here does not contain "arising under" or "arising out of" language found in *Prima Paint*. Rather, the language of sections 10.18 and 10.19 of the Merger Agreement is both plain and precise—requiring "the parties" to arbitrate only

disputes "*relating to interpretation or performance* of [the Agreement]." (Pet. App. 9a (emphasis by appellate court).)

Contrary to Maxim's contentions, neither *Prima Paint* nor California law favor arbitration of the tort claims at issue here. To reach the conclusion that the Cytovia Stockholders' claims are arbitrable, Maxim relies on several cases examining whether the language "arising out of" or "arising under" requires that fraudulent inducement claims be arbitrated. (Maxim Pet. at 13-14 n.3, and 15.) Maxim effectively redrafts the Agreement to read that "any and all disputes between the parties to the Agreement and the Cytovia Stockholders" are subject to arbitration. But the clause does not contain the "arising out of" or "arising under" language. Rather, it explicitly states that only claims relating to interpretation or performance of the Agreement are subject to arbitration, and only the parties' claims. (Pet. App. 9a.) Thus, the appellate court expressly found the Merger Agreement's clause is narrow—not broad—and determined clear evidence in the contractual language indicates the parties intended to exclude the Cytovia Stockholders' claims from arbitration. (*Id.* at 10a-13a.)

In the state court actions, the Cytovia Stockholders asserted no claims based on respondents' breach of or failure to perform under the Agreement, nor did they assert a claim based on the breach of contractual representations or warranties. (*Id.* at 11a.) Instead, they alleged Maxim defrauded them before they approved the merger. (*Id.* at 11a-12a.) The appellate court also noted that the Cytovia Stockholders' allegations related to false statements in press releases Maxim issued which induced the Cytovia Stockholders to support the proposed merger. (*Id.* at 12a.)

After reviewing the complaint's allegations in detail, the appellate court concluded that the factual allegations demonstrated the Cytovia Stockholders' tort claims against Maxim involve a dispute relating to a series of fraudulent representations and omissions that began *before* the Cytovia Stockholders approved the Merger and before the parties executed the Agreement. (*Id.* at 13a.) The appellate court therefore concluded that the Cytovia Stockholders' claims exist apart from any contractual theories and are outside the scope of the Agreement's narrow arbitration clause, as the claims do not involve a dispute relating to interpretation or performance of the parties' Agreement. (*Id.* at 13a–14a.) *See Bancomer, S.A. v. Superior Court*, 44 Cal. App. 4th 1450, 1461–62 (1996); *see also Britton v. Co-op Banking Group*, 4 F.3d 742, 748 (9th Cir. 1993) (finding that "subsequent, independent acts of fraud, unrelated to any provision or interpretation of the contract").

The court of appeal's decision is consistent with settled law at the time the parties to the Merger Agreement—Maxim, M80, and Cytovia—agreed to their contract. These parties expressly relied on the law at the time when interpreting the provisions and agreeing to be bound. As the Second Circuit has repeatedly recognized in declining to overrule *In re Kinoshita & Co.*, 287 F.2d 951 (2d Cir. 1961)—doing so would undermine the contracting parties' intent and result in a miscarriage of justice to change the law on which the parties relied and thereby change the meaning of the contract provisions. *See S.A. Mineracao Da Trindade-Samitri v. Utah Int'l., Inc.*, 745 F.2d 190, 194 (2d Cir. 1984).

C. Alternative Grounds Support the Judgment of the Court of Appeal and Thus This Court's Denial of the Petition, Specifically, the Merger Agreement's Express Terms Demonstrate that the Cytovia Stockholders Were Not Parties to It.

The appellate court elected to "assume without deciding [whether] the Cytovia Stockholders were either parties to or intended third party beneficiaries of the Agreement," and, based on its de novo review, held that in any event their claims were outside the scope of the arbitration clause. (Pet. App. 10a–11a.) Nonetheless, the court specifically noted that only Maxim, M80, and Cytovia were parties to the Merger Agreement. (*Id.* at 13a; Resp. App. 1.) An agreement to arbitrate is a creature of contract, and the ultimate question of whether a litigant agreed to arbitrate is determined by state law. *Bell v. Cendant Corp.*, 293 F.3d 563, 566 (2d Cir. 2002); *Paracor v. Fin., Inc. v. General Electric Capital Corp.*, 96 F.3d 1151, 1165 (9th Cir. 1996) ("an arbitration clause, is a contractual right and generally may not be invoked by one who is not a party to the contract in which it appears").

Maxim argues that the Cytovia Stockholders, as nonsignatories and nonparties, are bound to the Agreement. (Maxim Pet. at 10.) As noted above, the trial court found that the Cytovia Stockholders were third party beneficiaries of the Agreement. (Pet. App. 6a n.4.) Although the appellate court decided the issue of arbitrability based on the Agreement's scope, the decision can be upheld on independent grounds—that the Cytovia Stockholders were not parties to the Agreement and thus not parties to the Agreement's arbitration clause, nor were they third party beneficiaries to the Agreement.

1. The Cytovia Stockholders Cannot Be Compelled to Arbitrate Their Claims and Give Up Their Jury Trial Rights Under an Agreement to Which They Were Not Parties.

The premise of Maxim's argument is that any doubts about whether a dispute is arbitrable must be resolved in favor of compelling arbitration. Maxim, however, incorrectly concludes that the Cytovia Stockholders are "parties" to the Agreement, and therefore applies the presumption in favor of arbitration. (Maxim Pet. at 8–9.) "A proceeding to compel arbitration is in essence a suit in equity to compel specific performance of a contract." *Freeman v. State Farm Mut. Auto. Ins. Co.*, 14 Cal. 3d 473, 479 (1975). Thus, the Cytovia Stockholders cannot be compelled to arbitrate their claims unless they are parties to the Agreement or third party beneficiaries to it—the sole source of any agreement to arbitrate. *See Banner Entertainment, Inc. v. Superior Court*, 62 Cal. App. 4th 348, 356 (1998) (court order compelling arbitration simply compels specific performance of a contract).

The Merger Agreement expressly identifies its parties as: Maxim, M80 (a wholly owned subsidiary of Maxim) and Cytovia. (Resp. App. 1.) The Agreement cannot be so broadly construed as to encompass parties that were not intended by the express contractual language. *Thomson-CSF, S.A. v. Am. Arbitration Ass'n*, 64 F.3d 773, 77576 (2d Cir. 1995). The Agreement further expressly limits the scope of its arbitration clause to only those disputes "aris[ing] between the parties." (*See* Pet. App. 9a–10a n.7 (emphasis added).) The express contractual provisions thus compel a finding that the Cytovia Stockholders are not "parties" to the Agreement and thus are

not bound to its arbitration provisions. *Benasra v. Marciano*, 92 Cal. App. 4th 987, 991–92 (1992). To hold otherwise would rewrite the contract's express terms.

2. The Cytovia Stockholders Are Not Bound to the Agreement as Non-Signatories.

Maxim also contends the Cytovia Stockholders, as nonsignatories, are estopped from claiming the arbitration clause does not apply to their claims. (Maxim Pet. at 10 (citing *NORCAL Mutual Ins. Co. v. Newton*, 84 Cal. App. 4th 64 (2000)).) In *NORCAL*, the court held that a nonsignatory spouse who accepted a defense from her husband's medical malpractice insurer and demanded that the insurer pay to settle claims against her was bound by the policy's arbitration provision. *NORCAL*'s rationale is that a person cannot demand contract performance when it benefits him or her, and then try to avoid the contract's arbitration provision. *NORCAL*, 84 Cal. App. 4th at 84. Unlike the spouse in *NORCAL*, the Cytovia Stockholders demanded nothing under the Merger Agreement in suing appellants for fraud, and they received only what sections 1.5 and 1.6 specifically provided (stock exchange provisions) subject to express provisions that the Agreement's terms could not be invoked by or enforced against them. (Resp. App. 1a-4a.)

3. The Cytovia Stockholders Are Not Intended Third Party Beneficiaries Under the Merger Agreement as a Matter of Law.

Under California contract law, a party cannot be compelled to arbitrate its claims as a third party beneficiary unless the parties to the contract: (1) intended and (2) expressly provided the third party is a beneficiary.

Cal. Civ. Code § 1559 (permitting a litigant to be an intended third party beneficiary only if the contract is "made expressly for the benefit of a third person"). Further, only intended third party beneficiaries can invoke or be obligated under provisions of a contract to which they were not parties. *See Hess v. Ford Motor Co.*, 27 Cal. 4th 516, 524 (2002).

The distinguishing characteristic of third party beneficiaries is their "legal right to enforce contracts to which they are not a party." *Nationwide Mutual Ins. Co. v. Home Ins. Co.*, 150 F.3d 545, 550 (6th Cir. 1998). Without clear intent and express contractual provisions to the contrary, third parties to a contract are at most incidental beneficiaries without any rights or obligations who cannot be forced to comply with an arbitration clause. *See Jones v. Aetna Casualty & Surety Co.*, 26 Cal. App. 4th 1717, 1725 (1994); *Mariani v. Price Waterhouse*, 70 Cal. App. 4th 685, 704 (1999); Restatement (Second) of Contracts, §§ 302, 315 (1981). California law governing contract interpretation[2] determines whether the Cytovia Stockholders are intended third party beneficiaries of the Agreement. *Hess*, 27 Cal. 4th at 524.

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[2] "When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone." Cal. Civ. Code § 1639. "The whole of [the] contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other." Cal. Civ. Code § 1641. The parties' intent must appear "'on the terms of the contract.'" *Cal. Emergency Physicians Med. Group v. PacifiCare of Cal.*, 111 Cal. App. 4th 1127, 1138 (2003) (quoting *Jones*, 26 Cal. App. 4th at 1724). The objective intent of the contracting parties, as evidenced by the express language of the contract, not the subjective intent of one party, controls the interpretation. *Titan Group, Inc. v. Sonoma Valley County Sanitation Dist.*, 164 Cal. App. 3d 1122, 1127 (1985); accord *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).

Here, the Agreement's express language in section 10.14 explicitly barred the Cytovia Stockholders from claiming any rights under any provisions of the Agreement, other than the stock exchange provisions under sections 1.5 and 1.6. (Resp. App. 1a-3a.) Thus, in addition to the language of sections 10.18 and 10.19 governing arbitration between the "parties" to the Agreement, section 10.14 contains an express third party beneficiary disclaimer which precludes the Cytovia Stockholders from obtaining any rights other than exchanging their Cytovia stock for Maxim stock under sections 1.5 and 1.6. (*Id.*) Most probative of the parties' intent is their express exclusion of non-signatories as parties and the limitations of the Cytovia Stockholders' rights and remedies under section 10.14. (*Id.* at 4a.) Because no language in the Agreement suggests an intent to confer a direct benefit on the Cytovia Stockholders other than sections 1.5 and 1.6, which are expressly carved out of the third party beneficiary disclaimer in section 10.14, the Agreement's covenants and conditions run only to the parties (Maxim, M80, and Cytovia). Cal. Civ. Code § 1559. The provisions of the Agreement cannot be invoked by or against the Cytovia Stockholders. (Resp. App. 1a, 4a; *see also Hess*, 27 Cal. 4th at 524.)

Despite the express contractual language precluding the Cytovia Stockholders from being bound to the Merger Agreement's arbitration clause, Maxim relies on *Mormile v. Sinclair*, 21 Cal. App. 4th 1508, 1511 (1994), in arguing that the Cytovia Stockholders are bound to the Agreement as non-signatories under a third party beneficiary theory. *Mormile*'s facts and rationale are inapplicable.

In *Mormile*, a patient who signed the operative arbitration clause sued her doctor for malpractice. Her husband (a non-

signatory) asserted a loss of consortium claim. *Mormile*, 21 Cal. App. 4th at 1510. The arbitration clause provided: "All Claims Must Be Arbitrated: It is the intention of the parties that this agreement bind all parties whose claims may arise out of or related to the treatment or services provided by the physician, including any spouse or heirs of the patient." *Id.* (emphasis added). The court reasoned that this language was broadly drafted to include all claims arising out of the services for which the signatory spouse contracted. *Id.* at 1513. The court concluded that ordering the husband's claims arbitrated was consistent with the statutory goal of stemming escalating malpractice insurance costs and was essential to furthering the preference for joining claims for loss of consortium and negligence. *Id.* at 1511-12, 1515. The most important factor in the court's ordering the non-signatory spouse to arbitration, however, was the plaintiff/patient's right to privacy, which would be violated by a separate jury trial of a third party's claims. *Id.* at 1512, 1515.

In contrast to the Cytovia Stockholders, the husband in *Mormile* was explicitly recognized as a third party beneficiary in his wife's agreement. *Mormile* also concerned a specific statutory scheme and its particular policy concerns, which are absent here. Indeed, the public policy here is against depriving non-parties to arbitration agreements of their jury trial rights unless their waiver is clear and unmistakable. *Benasra*, 92 Cal. App. 4th at 992. Thus, where, as here, the contract language precludes third party beneficiaries, and the Cytovia Stockholders as non-contracting parties clearly disclaim third party beneficiary status, there is a strong policy against compelled arbitration in deference to the fundamental right to a jury trial. *Id.* at 990.

The Agreement's express language compels the conclusion that the Cytovia Stockholders are not bound to arbitrate; indeed, it would violate public policy to compel them to do so. If non-signatory stockholders of a company are bound to arbitration provisions of a merger agreement, despite express third party beneficiary disclaimer clauses, then all stockholders involved in corporate mergers which include an arbitration clause would be forced to arbitrate their claims. This result would unfairly deprive stockholders of their jury trial rights even where, as here, third party beneficiary status under the operative agreement is expressly disclaimed.

CONCLUSION

Maxim incorrectly assumes that the issue raised in its petition is presented in this case. The petition arises from an unpublished state court decision that binds only the parties. Even if the Court were inclined to review the issue, this is not the proper case to do so. Respondents are neither parties to nor intended third party beneficiaries to the contract that includes the arbitration clause of which Maxim seeks interpretation.

Respectfully submitted,

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APPENDIX — EXCERPTS OF AGREEMENT AND PLAN OF MERGER AND REORGANIZATION

AGREEMENT AND PLAN OF MERGER AND REORGANIZATION

This AGREEMENT AND PLAN OF MERGER AND REORGANIZATION ("*Agreement*") is maded and entered into as of June 2, 2000, by and among: MAXIM PHARMACEUTICALS, INC., a Delaware corporation ("*Parent*"); M-80 ACQUISITION CORP., a Delaware corporation and a wholly owned subsidiary of Parent ("*Merger Sub*") and CYTOVIA, INC., a Delaware corporation (the "*Company*"). Certain capitalized terms used in this Agreement are defined in Exhibit A.

* * *

1.5 Conversion of Shares.

(a) Subject to Sections 1.8(a) and 1.9, at the Effective Time, by virtue of the Merger and without any further action on the part of Parent, Merger Sub, the Company or any stockholder of the Company:

(i) except as provided in Section 1.5(a)(ii), each share of the common stock, par value $.001 per share of the Company (the "*Company Common Stock*"), outstanding immediately prior to the Effective Time shall be converted into the right to receive that fraction of a share of the common stock, par value $.001 per share of Parent ("*Parent Common Stock*") equal to the Exchange Ratio (as defined in Section 1.5(b)(i));

(ii) any shares of Company Common Stock then held by the Company or held in the Company's treasury shall be canceled and retired and shall cease to exist, and no consideration shall be delivered in exchange therefore; and

(iii) each share of the common stock of Merger Sub outstanding immediately prior to the Effective Time shall be converted into one share of common stock of the Surviving Corporation.

* * *

exercise any such repurchase option or other right set forth in any such restricted stock purchase agreement or other agreement.

1.6 Company Options and Warrants. At the Effective Time, each then outstanding Company Option or Company Warrant, whether vested or unvested, shall be assumed by Parent in accordance with the terms (as in effect as of the date of this Agreement) of the Company Stock Option Plan under which such Company Option was issued, if any, and the stock option agreement or warrant agreement by which such Company Option or Company Warrant is evidenced. To the extent that any Company Options are incentive stock options, within the meaning of Section 422 of the Code, the provisions of this Section 1.6 shall be interpreted and applied so as to comply with the requirements of Section 424(a) of the Code, so that such Company Options shall continue to qualify as incentive stock options after their assumption by Parent. All rights with respect to Company Common Stock under outstanding Company Options or Company Warrants

shall thereupon be converted into rights with respect to Parent Common Stock. Accordingly, from and after the Effective Time, (a) each Company Option or Company Warrant assumed by Parent may be exercised solely for shares of Parent Common Stock, (b) the number of shares of Parent Common Stock subject to each such assumed Company Option or Company Warrant shall be equal to the number of shares of Company Common Stock that were subject to such Company Option or Company Warrant immediately prior to the Effective Time multiplied by the Exchange Ratio, rounded down to the nearest whole number of shares of Parent Common Stock, (c) the per share exercise price for the Parent Common Stock issuable upon exercise of each such assumed Company Option or Company Warrant shall be determined by dividing the exercise price per share of Company Common Stock subject to such Company Option or Company Warrant, as in effect immediately prior to the Effective Time, by the Exchange Ratio, and rounding the resulting exercise price up to the nearest whole cent, and (d) all restrictions on the exercise of each such assumed Company Option or Company Warrant shall continue in full force and effect, and the term, exercisability, vesting schedule, acceleration rights and other provisions of such Company Option or Company Warrant shall otherwise remain unchanged. The Company and Parent shall take all action that may be necessary (under all Company Stock Option Plans and otherwise) to effectuate the provisions of this Section 1.6. Parent shall file with the SEC, within 90 days after the Closing Date, a registration statement on Form S-8 registering the exercise of the Company Options assumed by Parent pursuant to this Section 1.6.

* * *

Appendix

10.14 Parties in Interest. Except for the provisions of Sections 1.5 and 1.6, none of the provisions of this Agreement is intended to provide any rights or remedies to any Person other than the parties and their respective successors and assigns (if any).

* * *

10.18 Negotiations of Disputes. If a dispute arises between the parties relating to the interpretation or performance of this Agreement, including any right of setoff, and the parties cannot resolve the dispute within 30 days of a written request by either party to the other, such dispute shall be referred to the Chief Executive Officer, Chief Financial Officer or General Counsel of Parent and Chief Executive Officer, Chief Financial Officer or General Counsel of the Company for resolution. Such persons shall hold a meeting to attempt in good faith to negotiate a resolution of the dispute prior to pursuing other available remedies. If within 10 business days after such meeting, the Chief Executive Officer, Chief Financial Officer or General Counsel of Parent and the Chief Executive Officer, Chief Financial Officer or General Counsel of the Company have not succeeded in negotiating a resolution of the dispute, such dispute may be resolved through arbitration pursuant to Section 10.19.

10.19 Arbitration. Disputes that have not been successfully resolved pursuant to Section 10.18, with the exception of any claim for a temporary restraining order or preliminary or permanent injunctive relief to enjoin any breach or threatened breach hereof, shall be settled by a panel

of three arbitrators with such arbitration to be held in San Diego, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof. All arbitrators must be knowledgeable in the subject matter at issue in the dispute. The arbitrators shall make their decision in accordance with the terms of this Agreement and applicable law. Each party shall initially bear its own costs and legal fees associated with such arbitration and the parties shall split the cost of the arbitrators. The prevailing party in any such arbitration shall be entitled to recover from the other party the reasonable attorneys' fees, costs and expenses incurred by such prevailing party in connection with such arbitration. The decision of the arbitrators shall be final and may be sued on or enforced by the party in whose favor it runs in any court of competent jurisdiction at the option of the successful party. The rights and obligations of the parties to arbitrate any dispute relating to the interpretation or performance of this Agreement or the grounds for the termination thereof, shall survive the expiration or termination of this Agreement for any reason. The arbitrators shall be empowered to award specific performance, injunctive relief and other equitable remedies as well as damages, but shall not be empowered to award punitive or exemplary damages or award any damages in excess of any limitations set forth in this Agreement.

* * *

Supreme Court, U.S.
FILED
OFFICE OF THE CLERK

No. 04-1590

IN THE

Supreme Court of the United States

MAXIM PHARMACEUTICALS, INC.,
LARRY STAMBAUGH and KURT GEHLSEN,

Petitioners,

v.

CROSSPOINT VENTURE PARTNERS 1997, L.P., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEAL OF CALIFORNIA,
FOURTH APPELLATE DISTRICT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

Petitioner's Rule 29.6 Statement was set forth at page *ii* of Petitioner's Opening Brief, and there are no amendments to that Statement.

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I. INTRODUCTION

The Petition presents three questions appropriate for this Court's review. By their silence, Respondents impliedly concede the second two of these three questions. Respondents also do not directly respond to the first question presented by the Petition, asserting instead their own alternative questions. Respondents claim (incorrectly) that (1) the scope of the applicable arbitration provision is not a federal question; (2) no Circuit conflict is presented because the Ninth Circuit consistently applies its construction of the Federal Arbitration Act; and (3) there are alternative state law grounds for the appellate court's decision.

The Opposition fails to address the wealth of authority cited in the Petition. These cases confirm that the Petition presents a federal question: whether a fraudulent inducement or related tort claim can be encompassed by less than the broadest arbitration provision.[1] The cases cited in the Petition further demonstrate that there is a well-developed conflict among Circuits as to how this federal question should be answered. The minority view — followed by the Ninth Circuit and the California Court of Appeal — refuses to compel arbitration of fraudulent inducement claims under subjectively "narrow" arbitration provisions. This minority view conflicts with the strong policy in favor of arbitration stated in numerous prior Supreme Court decisions. However, this Court has never

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[1] The Petition also presents the question of whether the appellate court properly reviewed the question of arbitrability when the parties voluntarily submitted this question to the arbitrators and the arbitration provision incorporates the AAA Rules. Because this question was not addressed in the Opposition, no additional arguments are presented on Reply.

addressed the precise question presented by the Petition.[2] Finally, the state appellate court itself stated that there was no alternative state law ground for its decision. This Court should therefore grant the Petition.

II. THE PETITION PRESENTS A FEDERAL QUESTION

It is beyond dispute that the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, applies to transactions involving interstate commerce, such as the merger transaction between Maxim and Cytovia. Indeed, Respondents do not debate that the FAA applies to the arbitration provision in question.

In their Opposition, however, Respondents take contradictory positions as to whether the court below decided a federal question. Respondents argue, on the one hand, that the court below "decided no federal question." Oppo., p. *i*. On the other hand, Respondents argue throughout their brief that the state court ruled "under Ninth Circuit law." *Id*, *see also* p. 6 ("the opinion straightforwardly applies Ninth Circuit law") ("the court of appeal's decision did nothing more than correctly apply settled Ninth Circuit law to the dispute between these parties"); p. 8 ("The California appellate court properly applied Ninth Circuit law in determining the Cytovia Stockholder's tort claims are not arbitrable."). Respondents clearly do not dispute that the lower court based its decision on the Ninth Circuit's opinions. These opinions were constructions of federal law.

[2] Because of the Circuit conflict, Supreme Court Rule 10 is fully satisfied. In addition, many state courts of last resort follow the majority view that fraudulent inducement claims can be compelled even under narrow arbitration provisions. *See, e.g., In re J.D. Edwards World Solutions Co.*, 87 S.W.3d 546, 550-51 (Tex. 2002); and *A. Sangivanni and Sons v. F.M. Floryan and Co., Inc.*, 158 Conn. 467, 472-73 (1969). These decisions conflict with the Ninth and Second Circuits, thus establishing an alternative basis for satisfaction of Rule 10.

The crux of the opinion below was that the applicable arbitration clause was not broad enough to encompass Respondents' claims. This question as to the scope of the applicable provision is one of federal law. *See, e.g.*, *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) ("Federal law in the terms of the Arbitration Act governs [arbitrability of a dispute] in either state or federal court."); *Tracer Research Corp. v. National Envtl. Services Co.*, 42 F.3d 1292, 1294 (9th Cir. 1994), *cert. dismissed*, 515 U.S. 1187 (1995) ("the scope of the arbitration clause is governed by federal law"); *Bismarck v. Toltz, King, Duvall, Anderson & Assoc., Inc.*, 767 F.2d 429, 431 (8th Cir. 1985) ("Determining what claims fall within the class of disputes governed by an arbitration agreement is a question of federal law."); *Hart v. Orion Ins. Co.*, 453 F.2d 1358, 1361 (10th Cir. 1971) ("The validity and interpretation of arbitration clauses affecting interstate commerce are governed by federal law.").

In rendering its decision, the California appellate court "assume[d] without deciding" that the FAA applies. Moreover, the appellate court cited to and relied exclusively on federal cases interpreting the FAA for its conclusion that the dispute was outside the scope of the applicable arbitration provision.

The lead Ninth Circuit case cited by the appellate court is *Mediterranean Enters., Inc. v. Ssangyong Corp.*, 708 F.2d 1458 (9th Cir. 1983). In that case, the Ninth Circuit specifically held, "[f]ederal law therefore applies to our determination of the scope of this arbitration agreement." *Id.* at 1463. Respondents are simply mistaken when they contend that the Ninth Circuit applied California law in *Mediterranean*. Indeed, the court in *Mediterranean* further noted that neither party disputed the application of federal law. *Id.* at n. 4. In *Tracer*, the Ninth Circuit

similarly stated that "the scope of the arbitration clause is governed by federal law." *Tracer*, 42 F.3d at 1294.[3]

III. THE PETITION PROPERLY PRESENTS THE WELL-DEVELOPED SPLIT BETWEEN CIRCUITS

The Petition demonstrates that there is a conflict between the Circuits as to when a fraudulent inducement claim is subject to a contractual arbitration provision. Not only has this conflict developed, it is fully ripened.

Respondents respond by arguing that (1) the lower court's opinion was not published, and (2) there is no Circuit split because the opinion "straightforwardly applies Ninth Circuit law. . . ." Oppo., p. 6. Neither of these arguments carries any weight.

A. The Court Can And Should Review This Unpublished Opinion

It is well-established that an unpublished opinion may provide the basis for certiorari. *See, e.g., Kaupp v. Texas*, 538 U.S. 626, 629 (2003). In fact, the Court has at least twice recently granted certiorari of unpublished opinions by a California Court of Appeal after the California Supreme Court refused review (the situation at bar). *See Ewing v. California*, 538 U.S. 11, 20 (2003); *Perry v. Thomas*, 482 U.S. 483, 488-89 (1987) (reversing decision affirming the denial of a petition to compel arbitration).

Moreover, the fact that the lower court's opinion was unpublished actually supports review in this case. Such an unpublished decision gives no guidance to future litigants and therefore violates the strong federal policy in favor of arbitration. Other unfortunate litigants may again go through the process of

[3] Respondents fail to mention, let alone address, the Tracer decision.

compelling arbitration, having the appellate court deny an interlocutory appeal, arbitrating the matter, only to have their judgment reversed on appeal when the matter is deemed outside the scope of arbitration.

B. There Is A Well-Established Conflict Among Circuits Mandating Review

Respondents argue, in sum, that there is no Circuit conflict because the Ninth Circuit is internally consistent. In objecting to this Court's review, Respondents argue that the appellate court did not *create* a conflict of federal law. Of course, if the creation of a conflict were necessary, such conflict would never have time to fully ripen. In this case, the conflict at issue was not created by the California Court of Appeal, but its decision illustrates that such conflict is fully developed: the Ninth Circuit stands in a position out of step with most of the rest of the country, supported only most tenuously by the Second Circuit. The conflict is fully-ripened and ready for review.

Respondents' unsupported statement that "Maxim attempts to create a conflict where none exists," is simply untrue. As set forth in the Petition, over forty years ago the Second Circuit set down a rule under which "narrow" arbitration provisions — those limited to controversies related to interpretation and performance of a contract — do not encompass fraudulent inducement claims. *See In re Kinoshita*, 287 F.2d 951, 953 (2d Cir. 1961); *see also Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001) (under the Second Circuit rule, courts must first determine whether an arbitration clause is broad or narrow; narrow clauses do not encompass collateral matters).

Interestingly, Respondents mention *Kinoshita* only to make the point (as is stated in the Petition) that the Second Circuit

has not yet overruled it. Thus, though the Second Circuit has limited its holding to the precise facts of that case, district courts in the Second Circuit remain constrained to follow *Kinoshita* if they cannot distinguish a "narrow" arbitration clause. *See Bristol-Myers Squibb Co. v. SR Int'l Bus. Ins. Co.*, 354 F. Supp. 2d 499 (S.D.N.Y. 2005).

The Second Circuit rule has been adopted by the Ninth Circuit. *See Mediterranean Enters.*, 708 F.2d at 1463; *Tracer*, 42 F.3d at 1295. The California Court of Appeal has relied on the Ninth Circuit rule more than once. *See MHC Fin. Ltd. Partnership Two v. City of Santee*, 125 Cal.App.4th 1372, 1398 (2005) (explaining that the Ninth Circuit's rule means that a more narrow provision "encompasses only those actions directly involving the application of [the subject contract] in specific factual contexts addressed by the [the subject contract].").

In contrast to the Ninth and Second Circuits, a slew of other Circuits (cited in the Petition) have held that fraudulent inducement claims must be arbitrated even under provisions that require arbitration only of disputes "relating to the interpretation or performance" of an agreement—the exact language contained in the arbitration provision here.

Respondents claim that the Petition relies on cases in which the arbitration provision required arbitration only of matters "arising out of" or "arising under" a contract. Oppo., p. 10. In point of fact, the Ninth Circuit has held that an arbitration provision that uses the phrase "arising hereunder" is synonymous with one limited to disputes "relating to the interpretation or performance" of the contract. *Mediterranean Enters.*, 708 F.2d at 1464; *Tracer*, 42 F.3d at 1295.[4]

[4] This argument underscores one of the problems arising because of the Circuit conflict. Without a presumption of arbitrability of all (Cont'd)

Further, Petitioners cited numerous cases where courts in other Circuits compelled arbitration of fraudulent inducement-type claims where the applicable provision was almost identical to the provision at bar. *See Mar-Len of Louisiana, Inc. v. Parsons-Gilbane*, 773 F.2d 633, 636 (5th Cir. 1985) ("with respect to the interpretation or performance"); *Schacht v. Beacon Ins. Co.*, 742 F.2d 386, 391 (7th Cir. 1984) ("with respect to the interpretation of this Agreement or the performance of the respective obligations of the parties"); *RCM Tech., Inc. v. Brignik Tech. Inc.*, 137 F. Supp. 2d 550, 555 (N.J. 2001) ("as to interpretation of"); *Integrated Health Serv., Inc. v. Kirschenbaum*, 1996 U.S. Dist. LEXIS 3165, *17-18 (N.D. Ill. 1996) ("concerning the interpretation or performance of any provision"); *Hannah Furniture Co. v. Workbench, Inc.*, 561 F. Supp. 1243, 1244-45 (W.D. Pa. 1983) ("involving questions of interpretation of"); *J.P. Stevens & Co., Inc. v. Harrell Int'l, Inc.*, 299 So.2d 69, 70 (Fla. 1st DCA 1974) ("the effect or interpretation of any terms or provisions"); *see also Matthews*

(Cont'd)

disputes unless expressly excluded, the Ninth and Second Circuit Courts must subjectively determine whether a clause is narrow or broad, and such subjective determination results in inconsistent and unpredictable decisions. Thus, for example, "arising under" and "arising hereunder" are deemed "narrow" by the Ninth and Second Circuits (thereby depriving an arbitral forum to fraudulent inducement claims), but "arising out of" and "arising hereunder" are deemed sufficiently broad by the Sixth and Eleventh Circuits to support sending fraudulent inducement claims to arbitration. *See, e.g., Highlands Wellmont Health Network, Inc. v. John Deere Health Plan, Inc.*, 350 F.3d 568, 578 (6th Cir. 2003); and *Gregory v. Electro-Mech. Corp.*, 83 F.3d 382, 383-85 (11th Cir. 1996). A litigant (or person seeking to avoid litigation) has no way of knowing if the language in her arbitration clause will later be deemed broad enough to accomplish the arbitral goal. Or, worse, will find out that it was not broad enough only after an arbitration award has been entered and substantial fees incurred.

v. Rollins Hudig Hall Co., 72 F.3d 50, 54 (7th Cir. 1995) ("relating to a breach of this agreement"); *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.*, 867 F.2d 809, 813-14 (4th Cir. 1989) ("believed to constitute a breach or violation").

None of these cases were addressed in the Opposition. The Petition demonstrates that there is a split between Circuits where, in contrast to the majority view, the Ninth Circuit and Second Circuit reverse the presumption in favor of arbitration. In these two Circuits, parties are able to avoid any but the broadest contractual arbitration provisions by alleging that a contract was fraudulently induced. This Court should resolve this split and explicitly state that unless expressly excluded, fraudulent inducement claims fall within the scope of contractual arbitration provisions.

IV. THERE ARE NO ADEQUATE AND INDEPENDENT STATE LAW GROUNDS FOR THE LOWER COURT'S DECISION

The lower court specifically stated that it did not have an alternative state law basis for its decision. *See* App. A at 10a. While Respondents had argued, as they do in their Opposition, that they could not be bound to arbitrate their fraudulent inducement claims, the Court of Appeal specifically stated that it would "assume" that Respondents were either parties to, or intended beneficiaries of, the agreement containing the arbitration provision. The court also noted that it "need not reach the merits of" Respondents' contentions that they could not be bound by the arbitration provision. *See id.* at 10a and 17a, n.12. Again, the ***only*** basis for the appellate court's decision reversing the judgment confirming the arbitration award was that the dispute was beyond the scope of the applicable arbitration provision.

Even if the decision below applied an independent state law ground, such state law would not adequately support the lower court's decision. As the trial court properly found, although Respondents did not sign the merger agreement containing the arbitration provision, they were properly bound by it. Indeed, California law provides numerous bases under which Respondents would be bound. *See, e.g., NORCAL Mutual Ins. Co. v. Newton*, 84 Cal.App. 4th 64 (2000) (nonsignatory bound under estoppel theory); *Mormile v. Sinclair*, 21 Cal.App.4th 1508, 1511 (1994); *Harris v. Superior Court*, 188 Cal.App.3d 475, 479 (1986). Moreover, the mere fact (as asserted by Respondents) that the court below *might* have invoked state law grounds to overturn the judgment does not foreclose this Court's jurisdiction.

CONCLUSION

The Federal Arbitration Act should be uniformly applied in every Circuit, giving great weight to the policy in favor of arbitration. However, the Ninth and Second Circuits reverse the presumption in favor of arbitrability when faced with something less than a subjectively "broad" arbitration provision. The uneven application of this exception provides no real guidance to future courts and litigants. Petitioners therefore respectfully request that the Court grant their Petition for a Writ of Certiorari.

Respectfully submitted,

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No. 04-1590

IN THE

Supreme Court of the United States

MAXIM PHARMACEUTICALS, INC.,
LARRY STAMBAUGH and KURT GEHLSEN,

Petitioners,

v.

CROSSPOINT VENTURE PARTNERS 1997, L.P., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEAL OF CALIFORNIA,
FOURTH APPELLATE DISTRICT

SUPPLEMENTAL BRIEF

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CERTIORARI SHOULD BE GRANTED IN THIS CASE TO COMPREHENSIVELY RESOLVE THE CONFLICTS AMONG CIRCUITS AS TO THE REACH OF *PRIMA PAINT*

Petitioners file this Supplemental Brief to draw the Court's attention to a similar issue currently awaiting the Court's determination. On June 20, 2005, the Court granted Certiorari in *Buckeye Check Cashing, Inc. v. Cardegna, et al.* to determine whether the Federal Arbitration Act ("FAA") allows a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality. In seeking this determination, Petitioner Buckeye Check Cashing, Inc. asks the Court to find that the holding of *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) is not limited to its facts and, in so doing, affirm the strong policy favoring arbitration.

As in *Buckeye*, Petitioners here seek to have the Court confirm the federal policy in favor of arbitration and resolve a conflict among Circuits as to whether the holding of *Prima Paint* should be limited to its specific facts.[1]

Both petitions ask for the Court to confirm that it is for the arbitrator, not a court, to resolve disputes as to the validity of the contract containing the arbitration provision. Both ask the Court to affirm the presumption in favor of arbitration, even where facts differ from those at issue in *Prima Paint.*

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[1] Certiorari in *Buckeye* was granted after Petitioners filed their Petition for a Writ of Certiorari, and Petitioners did not have access to the *Buckeye* Opening Brief until after their Reply was filed. Thus, this Supplemental Brief comports with Rule 15.7.

At the very least, a decision in *Buckeye* should be highly illuminative to this case.

CONCLUSION

In *Buckeye*, the Court will instruct how severable (and thus enforceable) arbitration clauses are from their underlying contract and thereby clarify whether *Prima Paint* is limited to fraud in the inducement claims. In this case, the Court has the opportunity to settle whether fraudulent inducement claims are subject to contractual arbitration provisions, under the dictates of *Prima Paint*, whether or not an arbitration clause is subjectively "broad." By hearing both petitions, the Court can solidify the federal presumption of arbitrability. Petitioners therefore respectively request the Petition for Certiorari be granted or, alternatively, that the Court enter any relief that it deems just and appropriate under the circumstances.

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